ZENTRUM FÜR EUROPÄISCHE RECHTSPOLITIK

an der Universität Bremen

ZERP

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Eurohypothec & Eurotrust

Two instruments for a true European mortgage market after the EC White Paper 2007 on the Integration of EU Mortgage Credit Markets

ZERP-Diskussionspapier 7/2008

IMPRESSUM

Herausgeber:	Zentrum für Europäische
Redaktion:	Rechtspolitik an der
Vertrieb:	Universität Bremen
	Universitätsallee, GW 1
	28359 Bremen
Schutzgebühr:	€ 8,- (zzgl. Versandkosten)
Nachdruck:	Nur mit Genehmigung des
	Herausgebers
ISSN:	0947 — 5729

Bremen, im September 2008

Content

Introduction

This working paper is based on a speech given by the author at ZERP-Universität Bremen, in response to an invitation by Prof. Christoph Schmid, on 7th December 2007.

The topic of the Eurohypothec is older than 60 years now, but it is only recently that it has again assumed prominence on the European Commission's agenda.

It all began with the release of the Green Paper on the Mortgage Market 2005, which dedicated a whole point of discussion to the idea of the Eurohypothec, quoting a piece of research that contains the model of Eurohypothec that was created by a group of researchers after several years of studying the matter: the Basic Guidelines for a Eurohypothec 2005.[1] In December 2007, the EC White Paper, which deals with the steps required to advance the integration of EU mortgage markets, was released.

This working paper seeks to depict the Eurohypothec and the Eurotrust from the perspective of the EU Commission Green Paper 2005 and the EU Commission White Paper 2007, while providing a real case of a new mortgage law (the Spanish one) that does not achieve the same degree of usefulness that the Eurohypothec provides.

I. The Eurohypothec

1. The Eurohypothec as an ideal model of a Paneuropean real charge

When Eurohypothec researchers tried to achieve a "common mortgage" model for Europe, they searched for an ideal model, in the sense that it was not necessarily a real model, but one which would be as much **useful** as possible for purposes of the main goal: creating a Paneuropean mortgage tool that facilitates the creation of a true Paneuropean mortgage market.

Therefore, the currently presented model (the model in the Basic Guidelines 2005)[2] should, in any case, prove to be **more beneficial** than that offered by the current instruments of transnational mortgage funding. The typical transnational situation that the Eurohypothec seeks to address refers to the case where

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1 Drewicz-Tulodziecka, Agnieszka (Ed.), *Basic Guidelines for a Eurohypothec*, Mortgage Credit Foundation, Warsaw, 2005.

2 See below.

the lender is in a different EU country other than the piece of land which is to be used as security for the loan/loans to be granted to a borrower, irrespective of where he is.

This "more beneficial" idea should relate both to the lender and borrower:

a) Lender: the Eurohypothec should be able to facilitate the development of a legal framework for optimal Paneuropean mortgage lending and mortgage funding (active and passive operations of the mortgage market).

b) Borrower: Greater freedom in choosing (and changing) the lender, due to increased competition. According to a recent report by Mercer Oliver & Wyman for the European Mortgage Federation (2007),[3] a link exists between the decrease in costs of a mortgage and an increase in the concurrence among credit institutions in several European countries in recent years, as illustrated in Germany, Ireland, Greece, France and Belgium. The White Paper 2007 supports the same idea (p. 13).

One important question to be addressed before drafting the model was the impact and the efficacy of the Eurohypothec, that is, what was to be changed in the European mortgage market and when. The resulting decision would not only alter the way in which the model was conceived, but also its scope.

According to recently obtained results, the Eurohypothec is generating two effects:

1. At an initial stage, it is serving as:

– an inspiration for jurisdictions that do not have a well-functioning mortgage system or that do not have any at all (ie. as is still evidenced in some East-European countries);

– an inspiration to those jurisdictions that already have one, but are reforming it, in order to adapt to modern times and needs.

In essence, it is intended to indicate the direction to be taken by mortgage law reforms or implementations in each national jurisdiction. That is, what challenges are to be achieved in the modern context of law of mortgages in Europe. As a whole, what the benefits of a cross-border mortgage are; what answers it should provide and to whom.

In fact, following the introduction of the Basic Guidelines 2005, two "traditional" mortgage systems were reformed: the French, through the *Ordinance*

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3 European Mortgage Federation and Mercer Oliver & Wyman, *European mortgage markets – 2006 adjusted price analysis*, www.hypo.org.

23-3-2006[4] and the Spanish one, through the Act 41/2007[5]. These share something in common: they both consider the flexibility of their mortgage laws, which to a large extent, coincides with the goal of usefulness through the flexibility that governs the Eurohypothec pursuant to the Basic Guidelines. However, neither of them – as we will see in the Spanish case – has achieved the Eurohypothec's level of flexibility/usefulness.

2. At a second stage, the Eurohypothec should serve as a common instrument for the European mortgage market, thus helping to fulfil the goals of the EU: freedom of people and freedom of capital throughout EU member states. It should be a useful and optimal common transnational mortgage instrument. This second stage does not require any changes to the legal framework for mortgages in any national jurisdiction, as far as the Eurohypothec does not try to substitute any of the already existing national mortgages.

3. At a third stage, national jurisdictions should realise the importance of adapting their own legislation to maximise the benefits provided by the Eurohypothec- once it is clear to them, for example, that their enforcement procedures are not timely or that their insolvency law does not sufficiently secure the mortgagee. These – and some other – factors would make the Eurohypothec granted in that particular country to be more expensive (more difficult to be granted, higher interest rate for the borrower) than the same instrument in another jurisdiction with better legal infrastructures, which would in turn cause prejudice amongst its citizens, thus leading to further legislative reforms.

2. Why talk about the Eurohypothec?

As mentioned previously, the idea is far from new. Prof. Claudio Segré instigated the concept of creating a common mortgage instrument in the 60s – as commissioned by the EC. His proposed model was the Swiss *Schuldbrief*. Progressive work on the Eurohypothec, was undertaken in the following years by certain institutions such as the International Union of Latin Notaries and by renowned authors (more intensively by Prof. Wehrens[6] and Dr. Stöcker[7]).

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4 Ordonnance n°2006-346, 23-3-2006 (JORF 24-3-2006).

5 See below.

6 Wehrens, Hans G., *Überlegungen zu einer Eurohypothek*, "Wertpapier Mitteilungen – Zeitschrift für Wirtschafts- und Bankrecht", num. 14, April 1992, pp. 557 a 596.

7 Stöcker, Otmar, *Die Eurohypothek*, Berlin, 1992, Ed. Duncker & Humblot. The most recent article on this topic is Stöcker, Otmar, Real estate liens as security for cross-order property finance. The Eurohypothec, a security instrument with real prospects, "Revista Crítica de Derecho Inmobiliario" (Spain), num. 703, 2007, pp. 2255-2277.

In 2004, a special research group was set up to study the Eurohypothec (www.eurohypothec.com). This group not only organized several research events, but also took part in seminars that resulted in the redaction of the Basic Guidelines 2005, which also involved the participation of researchers from different groups and backgrounds. A few months later, the Internal Market Affairs Department of the European Commission issued the Green Paper on Mortgage Credit 2005, which at some point addressed a question considered by governments, mortgage market stakeholders and researchers on the usefulness and importance of the Eurohypothec. The response was very positive as can be seen in Table 1.

	IN FAVOR OF THE BASIC GUIDELINES EUROHYPOTHEC MODEL	IN FAVOR OF THE IDEA OF THE EUROHYPOTHEC, BUT WITH ANOTHER MODEL	HAVE DOUBTS/NEED MORE INFORMATION	AGAINST THE EUROHYPOTHEC IDEA
GOVERNMENTS	CYPRUS POLAND CZECH REPUBLIK IRELAND FINNLAND	HUNGARY SPAIN	SWEDEN	ESTONIA GERMANY AUSTRIA
CORPORATIONS	Citigroup Inc., International Search-Flow, UK Crédit Agricole (CA), FR Halifax Bank of Scotland plc (HBOS), UK Lloyds TSB Group, UK Royal Bank of Scotland Group (RBS), UK	BBVA, ES	Baclays PLC, UK GMAC – RFC Limited, UK HVB Group, DE	ABN AMRO, NL Banca Intesa, IT
EU INSTITUTIONS	European Central Bank — Eurosystem, EU European Economic and Social Committee			

Table 1. Response to the Eurohypothec question as illustrated by the Green Paper on Mortgage Credit in the EU.

Although a more extensive study of these responses can be found elsewhere,[8] the conclusion to be derived is that most respondents were either in favour of regulating the Eurohypothec, according to the model foreseen in the Basic Guidelines 2005, or proposed another model.

8 See Nasarre Aznar, Sergio, *Reacciones en torno a la Eurohipoteca al Libro Verde de la Unión Europea sobre el crédito hipotecario*, at Muñiz, Nasarre y Sánchez Jordán, "Un modello para una Eurohipoteca. Desde el Informe Segré hasta hoy", Cuadernos de Derecho Registral, Madrid, 2008, Colegio de Registradores de la Propiedad y Mercantiles de España.

Despite the positive response to the idea, the EU Commission has continued to rely on an institution – the European Mortgage Federation, a representative of lending institutions in Europe – which for many years has not supported the idea of achieving such a common instrument for trans-national mortgage operations. The created sub-group unit within the EMF was closed during 2006, without any enthusiastic support for the creation of the Eurohypothec.

However, other sub-groups created by the EC Commission for the purpose of investigating other areas of the Green Paper have worked more actively and with more enthusiasm towards European convergence in their fields of knowledge. In fact, they have seized the opportunity to raise certain issues surrounding the mortgage market that substantially coincide with the features of the Eurohypothec, as foreseen in the Basic Guidelines. The two main reports relating to these issues included those of :

A) *The Mortgage industry consumer dialogue group (MICDG)*. Composed of consumers and lenders, few agreements were concluded because of variations in opinions, which related to important matters. Conclusions in three very relevant areas were however achieved namely:

Precontractual information

- When should it be given? The question was related to whether it should be given before or after the customer had provided his details (the latter being the bank's option) and in which timeframe.
- Improvements to the ESIS (European Standardized Information Sheet)[9], that is, whether the ESIS should include more accurate information in relation to the mortgage that the consumer was going to take out.
- Efficacy of the Code of Conduct on mortgages. While today, this is only a matter of voluntary application by some credit institutions in Europe, consumers in the sub-group wanted to make it compulsory, while banks considered that this would lead to more rigidities in mortgage operations.

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9 The obligation to give consumers (mortgagors) this standardised Sheet with all information regarding to the mortgage loan, which makes easier to them to compare the conditions under which mortgage loans are offered before the conclusion of the contract, was introduced by the Voluntary Code of Conduct on Pre-Contractual information for Home Loans, which was negotiated between European conumer associations and the European mortgage lending industry. More infromation at Annex 3 White Paper 2007, pp. 12 and 13.

Assessment

– INFORMATION (description of the product) should be differentiated from ASSESSMENT (recommendation of the product) and from RISK WARNING (lender should rate the indebtedness capacity of the borrower).

Pre-payment rights

– Significant differences exist between this being a contractual right (lenders) or a statutory right (consumers). In addressing country opinions, countries like Spain have granted to consumers a statutory right to enable prepayment of any amounts of the loan at any time – although in Spain, credit institutions are able to charge extra fees to compensate for the losses they may incur (prior to the Mortgage Reform 2007 -which attempts to address the problem- such losses were unduly calculated). The situation in other countries is the opposite: credit institutions and consumers may agree to foresee (more expensive mortgages, that is, worse conditions and higher interest rates for consumers in exchange of the freedom) or not to foresee (less expensive mortgages) prepayment rights for consumers.

This report was interesting for the Eurohypothec conception process because it made clear the point that the "contractual" aspect of a mortgage loan relationship is one thing, whilst its "real" (right in rem) part is another. The Eurohypothec has no connection to the contractual aspect and therefore has no links with the contractual aspects of consumer protections at all. It is only related to the "right in rem" aspect in the sense that it only deals with a model of security right on real estate, that is, the mode in which the lending contract, which will include all necessary consumer-protection issues, will be secured. Some other issues, like prepayment rights, may have a direct impact on the passive operations of the mortgage market, that is, the "stability" and "foreseeability" of mortgage securities (especially, covered bonds).[10]

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10 In a broad sense, mortgage securities –mainly mortgage-backed securities (MBS) and covered bonds- are those securities, backed either by a pool of mortgages held by a Special Purpose Vehicle (SPV) –the MBS- or by the originator of the backing mortgages itself –the case of covered bonds. Mortgage securities are the passive side (in some cases known as the secondary mortgage market) of the mortgage market (the active side is, essentially, the granting of mortgage loans), which means that mortgage securities refinance (fund) credit institutions' business of mortgage lending. The better the mortgage funding is, the better conditions and the better interest rates mortgage loans have. See below for more details and see also Nasarre Aznar, Sergio, *Securitisation & mortgage bonds. Legal aspects and harmonization in Europe*, Saffron Walden

B) The *Mortgage funding expert group* (MFEG), composed only of lenders, of course, concluded more agreements. The issue relating to mortgage securities was precisely the central discussion point addressed by the MFEG. These discussions have produced some interesting points:

- The concept of "**mortgage market**" is a complete one, as it includes both active operations (lending) and passive operations (mortgage funding). It now seems definitely clear that mortgage lending operations cannot be understood without a complete and well-functioning (from a financial and from a legal point of view) mortgage funding system.[11]
- Need to **integrate passive operations on the mortgage markets**. Today 60% of all European mortgage loans (long term investments) are still inadequately funded by credit institutions by deposits (short term). Only 17.5% are funded through covered/mortgage bonds whilst 10.5% are funded through mortgage-backed securities (MBS),[12] this percentages should be increased to be able to avoid in the future the "lending long, borrowing short effect".[13]
- **Larger and more diversified** mortgage pools. The geographical diversification is one of the most important types of diversification which exists within those pools of mortgage backing- be it the MBS or covered bonds. This is today, rather too complicated to be achieved at a Paneuropean level due to the low level of foreign mortgages that an EU credit institution has, mainly due to lack of a common mortgage instrument (the Eurohypothec).
- Greater **diversity of mortgage products**. There are still several jurisdictions that lack specific mortgage funding instruments, either covered bonds, MBS or both.
- Desirable characteristics of the Paneuropean mortgage market: **completeness, competitiveness, efficiency, transparency and stability**. Completeness implies that every EU credit institution should possess

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(UK), 2004, Ed. Gostick Hall for their study in Europe.

11 See footnote 10 above for a reference to the mortgage funding system.

12 See footnote 10 above for a reference to MBS and convered bonds.

13 This effect causes mismatches due to liquidity and to different interest rates between the deposits and the issued mortgage securities (see the important crisis in the US during the late 80s which caused the winding up of thousands of credit institutions due to this effect). See more details at Nasarre Aznar, Sergio, Securitisation & mortgage bonds. Legal aspects and harmonization in Europe, Saffron Walden (UK), 2004, Ed. Gostick Hall for their study in Europe.

the required facilities and capacity for choosing the mode of mortgage funding that it considers most appropriate; competitiveness refers to a subordination of all barriers to facilitate negotiation of cross-border loans with mortgage loans (obviously, the Eurohypothec should play an important role here); efficiency implies greater liquidity and product diversification, forgetting the importation of the US model of the Federal Agencies (Fannie Mae, Ginnie Mae and Freddie Mac)[14], which have recently (2004) been revealed as inadequate for a healthy mortgage market, although there have been some attempts to create the European Mortgage Finance Agency; product diversification in passive operations markets is difficult to achieve in an environment in which there is scarcity of transnational mortgage business; transparency infers that mortgage securities' legal and financial structures should be more comprehensible both for investors (both professional and non-professional) and for rating agencies; in fact, this has been one of the most important reasons for the internationalization of mortgage market crisis of Summer 2007: lack of transparency of the real risks that were borne by investors in MBS backed by sub-prime US mortgages, such as European professional investors linked to banks, funds or insurance companies; and stability refers to a process whereby passive operations of mortgage markets should bring about a sufficient degree of risk diversification in the mortgage markets.

- **Active operations**: pre-payment rights? – the same issue that is addressed by the MICDG but this time, due to the lack of consumer's participation in MFEG, clearer goals are achieved-; land valuation standards; flexibility of trans-national transfer of mortgages; efficient Land Register; efficient mortgage enforcement and consumer data protection.
- **Passive operations:** introduction of new legislations on covered bonds, to reduce risk in MBS pools and to create a truly Paneuropean market on mortgage securities. This is, of course, the ideal counterpart in the "passive side" for the Eurohypothec.

14 These are US Federal Agencies that, after buying good quality mortgages from lenders (originators), issue MBS. For more details see Nasarre Aznar, Sergio, Securitisation & mortgage bonds. Legal aspects and harmonization in Europe, Saffron Walden (UK), 2004, Ed. Gostick Hall for their study in Europe.

Therefore, even if the White Paper 2007 of the EU on Mortgage Credit had not specifically mentioned the Eurohypothec, many of its principles and objectives would already be there. In essence, the creation of a true Paneuropean mortgage market cannot be achieved by addressing only the passive operations side.

However, the White Paper 2007 referred to the Eurohypothec and to the Eurohypothec's goals. The White Paper was released on 18-12-2007[15] and has addressed the following issues which relate directly to the topic of this work:

a) The mortgage credit market represents 47% of the European Union GDP. Therefore it is an important area, which should be **integrated**. This integration has been calculated to allow for an increase of 0.7 % of the EU GDP.

b) The EU Commission aims to **facilitate the cross-border supply** of mortgages (p. 3; bold is mine).

c) The EU Commission aims to facilitate cross-border funding of mortgage credit. It literally states that: "The existence of differing legal and consumer protection frameworks, fragmented infrastructures (e.g. credit registers), as well as the lack of appropriate legal frameworks in some instances (e.g. for mortgage funding), **create legal and economic barriers, which restrict cross-border lending** and prevent the development of cost-efficient, pan-EU funding strategies. The Commission therefore seeks to remove disproportionate barriers, thus reducing the costs of selling mortgage products across the EU" (p. 3; bold is mine). It continues: "However, economic and **legal barriers also exist which prevent mortgage lenders from offering certain products in certain markets** or opting for a given funding strategy" (p. 3; bold is mine). Therefore, although it does not mention the Eurohypothec, it talks about the same goals that the latter pursues.

d) As regards mortgage securitisation, it states that "The aim should be to facilitate, and not restrict, the **development of a wide range of mortgage funding instruments**" (p. 4; bold is mine). As regards the use of pan-European mortgage loans to back covered bonds, it states that "the prohibition of including non-domestic EU mortgage loans in cover pools for covered bonds, which currently exists in some Member States, is compatible with the free movement of capital and the freedom to provide services" (p. 8). It envisages the creation of an Expert Group on Securitisation for 2008 (p. 9). The EU Commission refers to the same things we ad-

15 COM(2007) 807 final.

dressed with Eurosecuritisation and the cross-border transfer of mortgage loans to back covered bonds.[16]

e) The European Commission seeks to **facilitate customers' mobility** "by ensuring that consumers seeking to change mortgage lenders are not prevented or dissuaded from doing so as a result of the presence of unjustifiable legal or economic barriers", thus avoiding "tying" practices (p. 5). See below new restrictions by Spanish Act 41/2007.

f) The European Commission encourages member states to join **EULIS**, which is commented on below as a good complement to the Eurohypothec: one cannot be fully understood without the other.

g) As conclusion, it draws the following: "To be effective, any proposed measures must demonstrate that they will **create new opportunities for mortgage lenders to access other markets and engage in cross-border activity**. They should also demonstrate the capacity to facilitate a more efficient mortgage lending process, with economies of scale and scope, which should lower costs. The expected benefits should be weighed against the possible costs of these measures".

h) The Eurohypothec expressly appears in two Annexes of the White Paper:

   – Annex 2: Process (Commission Staff Working Document-Accompanying the White Paper on the Integration of EU Mortgage Credit Markets-Impact Assessment), which states that the Eurohypothec (referred to as "Euromortgage") is a matter of study after the Green Paper 2005 release.

   – Annex 3: Impact assessment on specific issues (Commission Staff Working Document-Accompanying the White Paper on the Integration of EU Mortgage Credit Markets-Impact Assessment, pp. 168 and 169), in the field of transfer of mortgage portfolios, a solution would be "to issue a recommendation to Member States [...], to issue legislation or to create the '**Eurohypothec'**, as an alternative instrument for securing loans on property to existing national concepts of collateral" (bold is mine) and recommends further research.

As can be seen throughout this paper, the Eurohypothec is fully compliant with the objectives of the White Paper 2007 and the most appropriate instrument to achieve them.

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16 See below.

3. Need for the Eurohypothec

The creation of a complete European mortgage market would not necessarily require a common mortgage instrument if this lack could be compensated by suitable alternative instruments. However, such instruments are not effective. Figures reveal that currently, only 1% of European mortgage lending operations are being undertaken cross-border, which is really a low figure (Green Paper 2005). The inadequacy of the main instruments and tools of legal integration to achieve a single European mortgage market may be shown as follows:

a) **Mutual recognition**. On the basis of the Cassis de Dijon decision of 1979, unless a particular justification is given, no barriers can be imposed on free circulation of merchandise if safety control requirements have already been fulfilled in an EU country. Several cases which followed Cassis de Dijon, like the Centros Case, Überseering and Inspire Art, have compelled EU Member States to accept other Member States corporative forms. However, the mutual recognition principle applied to the diversity of mortgages in Europe (for sure more than 27) would mean that every national mortgage (each of the at least 27), as they are governed by the *lex rei sitae*, would be valid (and should be able to be properly created) in every country, which would be completely chaotic for every jurisdiction (given the difficulty of integrating into one's jurisdiction more than 26 types of foreign mortgages).

   In the field of **mortgages**, the most renowned case has been the Trummer and Mayer Case.[17] Austria had put in place a prohibition to create mortgages referenced to a foreign currency to avoid the publicity of a not-completely clear value of the mortgage (due to daily currency fluctuations). The European Court of Justice considered this reason as insufficiently strong to prevent the application of free movement of capital. Only if a national mortgage system were affected in such a way that it did not assure the rights of mortgage lenders and third parties, would this measure be acceptable.

b) **Transposition into a minus**. This principle implies that when a foreign right is incorporated into a national legal system, it should be applied in such a way that the legal quality and status of that right is not improved. However in the field of mortgages, this would mean that as regards a foreign mortgage, the mortgagee's position would be worsened when it was incorporated into a national legal system.

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17 (C-222/97) ECR 1999, I-1661.

4. The Idea behind the Eurohypothec

The Eurohypothec model presented in the Basic Guidelines 2005 was conceived as a **secure**, **flexible Paneuropean** instrument – which corresponds with the foundations of the White Paper 2007 on the integration of EU mortgage credit markets.

a) Security. The common core of all charges on land in Europe that may be used to secure obligations is that they can function as instruments enabling **land to be used as security** with some kind of **preference** – a claim that may be raised by a secured creditor. Apart from this starting point (using the land to secure debts with some kind of privileged right), no further common features may be found among any securing charge on land in Europe. The Eurohypothec should include this starting point in its foundations, however everything that is connected to it would appear unfamiliar to one or more legal jurisdictions (e.g. the contractual dependence arising from the secured obligation/s is not familiar to almost every South-European country; the fact that the Eurohypothec is able to secure all types of obligations – including the non-monetary ones – would come as a surprise to many common law lawyers, etc.). However, it would be unreasonable to discontinue with this integration for this reason. The Eurohypothec should be as **minimally intrusive** as possible to national jurisdictions but above every other thing, it should be as beneficial as possible both to lender and borrower (this is its main cornerstone). To be effective, the Eurohypothec should have the same privileged rank in terms of foreclosure anywhere in Europe. However this cannot easily be achieved in the second phase; therefore, a third phase is required, once a model has been agreed upon. This would be the optimal situation; if this solution could not be achieved, at least a Eurohypothec should still have the same rank as other national mortgages (with which it would coexist). Finally, an excellent partner for the Eurohypothec would be a common European Land Register. A first step in this direction would involve the *European Land Information Service* (EULIS) Project (www.eulis.org), which during its first stage (lasting till 2004), included two aspects: an on-line portal to access the already computerized national land registers and the "legal part" that includes definitions of legal institutions (in English) which are required to understand the legal situation of a plot of land (property, land charges, etc.) and their translation from one national language to the other. In its current stage, EULIS is fully operational and 8 national land registers and cadastres can be accessed through EULIS portal. Plans currently exist to extend it to many other registers and cadastres. As currently conceived, EULIS would serve as a useful tool not only to

increase transnational land conveyancing, but also for the registration of land charges (lender can easily check from his home country for all legal and physical details of the land that is to be accepted as security for the loan they intend to grant), which should evolve to true European e-conveyancing relating to land in future (in a similar way to what the English Land Registration Act 2002 foresees).

b) Flexibility. In order to be able to employ the Eurohypothec in every business involving mortgages conceivable today (and many others that could be conceived in the future that require a flexible real estate security), it should be "released" from those legal ties which restrict its flexibility: its legal accessoriness to the secured obligations. The Eurohypothec, as a right, should be regarded as an entity (**value**, in economic terms) on its own, disregarding the purpose for which it is being used at a particular point in time: from the passive perspective of being a charge over land, it should evolve to the more active one of making value of land. Only in such case could the Eurohypothec be assigned separately from the secured loan for funding purposes or would the borrower be able to reuse it for as many times as desired with the same or with a different lender. This should be understood as a general rule, which can be overlooked in some cases for consumer protection purposes (e.g. in the case where the lender assigns the Eurohypothec and the secured loan separately to two different third parties and both want foreclosure their rights against the borrower; in such a case, the latter should be entitled to invoke the relevant exceptions in order to avoid paying twice; this should be possible on the basis of the principle of unjust enrichment and on grounds of misbehaviour on the part of the lending institution.[18]

c) Paneuropean. This implies that the Eurohypothec should serve as a common instrument. It should be accessible throughout Europe and be capable of co-existing with other national types of mortgages. Based on what has already been said about its uses, flexibility and function as a security, finding an appropriate model for the Eurohypothec would be of great benefit. The following are, broadly speaking, the basic hypothecs models currently in force in Europe:

   – The continental accessory mortgage. This is the most widespread model type in Europe, which has prompted some authors (e.g. Wachter[19], Gómez Galligo[20]) to propose it as an ideal model for the Eu-

18 See below.

19 Wachter, Thomas, *Die Eurohypothek-Grenzüberschreitende Kreditsicherung an Grundstücken im Europäischen Binnenmarkt*, "Wertpapier Mitteilungen – Zeitschrift

rohypothec. It is present in almost every EU country but has disadvantages in relation to the independent mortgage. These disadvantages are linked to its legal accessoriety with the secured loan. This means that anything which happens to the contractual relationship between lender and borrower would also affect the hypothec (e.g. no hypothec may exist without a securing loan; once the loan is extinguished so is the hypothec; their assignment must take place at the same time etc.). Moreover, authors supporting this idea do not provide any solutions to combine an accessory type of a Euromortgage with a Eurotrust.[21]

– The continental European independent mortgage. It has its origins in Germany (*Sicherungsgrundschuld*) and Switzerland (*Schuldbrief*), but its use is widespread throughout the East-European countries such as Estonia (*Hüpoteek*), Poland (*Dług na nieruchomości*, still a project), Slovenia (*Zemljišzi dolg*) and Hungary (*önálló zálogjog*). Its advantage consists in being able to operate with any type of business and its disadvantage involves the hypothetical reduced protection for the borrower.

– The Scandinavian independent mortgage.[22]

– The common law "mortgage", present in the UK and Ireland. Although certain features exist that make the common law mortgage as flexible as the continental independent mortgage (ie. its virtue to adapt to any type of loans, the possibility of creating or conveying it in equity, that is, with less requirements than with its legal form), the point is that the mortgage itself belongs to a specific legal environment: the common law and equity. The Anglo-American legal system cannot be exported at this point because the fact that the mortgage entails a 3,000 year lease – which is still so in its legal nature – cannot be understood abroad; moreover, the fact that the mortgage is, at the same time, a

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für Wirtschafts- und Bankrecht", num. 2, January 1999, pp. 49 to 104.

20 Gómez Galligo, Francisco Javier, *La eurohipoteca: el sistema hipotecario español como modelo de referencia*, "Estudios de derecho de obligaciones: homenaje al profesor Mariano Alonso Pérez / coord. por Eugenio Llamas Pombo", Vol. 1, 2006, pp. 927-947. In the author's opinion, the Spanish mortgage should serve as a model for the Eurohypothec.

21 See below.

22 For all relevant information on this type of land charge, see Jensen, Ulf, *Panträtt i fast egendom*, 6th Edition, 2001, Iustus. As a general idea, it may be stated that the Swedish mortgage is an independent (from the loan) and quite simple (the whole system of registration and dealing) type of mortgage as compared to the majority of European models.

loan and a *right in rem* is also a difficult concept to understand outside Anglo-American systems because civil law countries have a model of *rights in rem* that secure contracts and other obligations.

Against this background, it will be shown how the Eurohypothec model of the Basic Guidelines 2005 has adopted the most appropriate aspects of each of the stated models to achieve the maximum possible level of security and flexibility.

5. Model of the Eurohypothec in the Basic Guidelines 2005

Although an extensive study of the Eurohypothec model in the Basic Guidelines is still required, some related works have already been published.[23] However, for now, we will only highlight the main features that help to build an operative concept of the Eurohypothec:

A) Concerning the legal nature

- It is a **real charge**, which confers on its owner a preferential right over a piece of land (i.e. using it as a security for a loan(s)).
- It does not substitute **national mortgages**; it should coexist with them in each national jurisdiction. This is fully in compliance with the aim of the White Paper 2007 of increasing the mortgage products' diversity (p. 4).
- It is **contractually dependent** on the obligations it secures; it may not require any obligation to exist.
- To be used as a security, a **security contract** should exist. It should provide for minimum contents (which obligations to secure, use of the Eurohypothec, conditions for redemption and enforcement). Form: *lex rei sitae* and Art. 9 para. 6 Rome Convention 1980.
- Possibility for **complete redemption** (devolution) or a **partial** one.
- It does not generate interests; its constitution costs should be the same as those of national mortgages; the Eurohypothec extends to chattels and fruits of the land; it can be created in relation to any currency of the EU.

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23 The most recent one is the translation of the Eurohypothec model of the Basic Guidelines into Spanish, while commenting some of its features: MUÑIZ, NASARRE y SÁNCHEZ JORDÁN, *Un modelo para una Eurohipoteca. Desde el Informe Segré hasta hoy*, Cuadernos de Derecho Registral, Madrid, 2008, Colegio de Registradores de la Propiedad y Mercantiles de España.

B) Constitution

- Only the **owner** of the land can create it, with or without the intervention of the creditor.
- It must be **registered** in the Land Register to exist (amount, owner and form).
- It can adopt **two forms**: "register Eurohypothec" and "letter Eurohypothec". It can be managed electronically.
- Object: **any land in Europe** and any other immovable object, according to *lex rei sitae*.
- **"Trans-national eurohypothecs"** and **"multi-parcel eurohypothecs"**.
- It is possible to hold a Eurohypothec or part of it on **trust** for another.

C) Transfer

- It will **depend** on the way it has been created: if it is a "register" Eurohypothec, transfer will be done through the Land Register; if it is a "letter" Eurohypothec, this will be done only by the delivery of the letter to the transferee.
- The Eurohypothec can be **conveyed independently of the secured obligation** to a different third party.
- The debtor can **oppose real pleas and objections** against the transferee. Therefore, the security contract should have their party effect; if this were not possible, the tort liability of the transferor might be an alternative.

D) Extinction

- It is extinguished through **cancellation** in the Land Register, as a result of an agreement between the owner and, in its case, the creditor.
- **It is not extinguished** through passage of time.
- The **fulfilment** of a secured obligation **does not imply its extinguishment**; its effects will be determined in the security agreement.

E) Enforcement

- Its **efficacy** depends on the **process and duration of its enforcement** (max.12 months)
- The Eurohypothec is an **enforceable title** in itself (*lex rei sitae*) + constitutes an enforceable claim against the owner (*Schuldverprechen*) (*lex rei sitae*; that is, only in those jurisdictions in which this is allowed).

- It should end through **sale at a public auction** (interdiction of *the droit de voie parée – briefly explain what this is*).
- In the case of pleas and objections, the **burden of proof** lies with the owner of the Eurohypothec.
- Higher **ranked** rights stand still; those with the same or a less good rank are extinguished; there is the possibility of the substitution of the mortgagee, replacing him and occupying his rank
- **Insolvency**. Same security as in enforcement. Possibility of separate enforcement.
- An **efficient Land Register** is required: public charges need to be registrable, with their rank and publicity being ensured
- **Implementation**. The Eurohypothec constitutes a model solution which might be turned in an optional 28th regime.

6. Questions about the model

According to our experience and feed-backs we have received, several questions have arisen whenever the model was explained.[24]

- Lack of **economic studies**. If the implementation of the Eurohypothec is a rather long and difficult endeavour, one might call for empirical evidence to show in advance if it is a worthwhile process, economically speaking. However, working on the assumption that one common single instrument is better than having at least 27 different ones, might also be defendable. In this context, the White Paper 2007 (p. 13) requires that any new measures "should demonstrate that they will create new opportunities for mortgage lenders", although it already includes several observations that illustrate the benefits of the integration of mortgage markets (pp. 3 to 5).
- The proposed "**contractually dependent mortgage**" is **generally unknown** in Europe: this could generate concerns. In addition, some might argue that the already existing legally dependent mortgages are flexible enough. In addition, two further concerns are often voiced: first, the Eurohypothec, as foreseen in the Basic Guidelines of 2005, would not be able to operate in causal jurisdictions, that is, in jurisdic-

24 See a discussion about pros and cons of the Eurohypothec at European Bank for reconstruction and development, Mortgages in transition economies. The legal framework for mortgages and mortgage securities, United Kingdom, 2007.

tions where the "*causa*" is a relevant requirement for a valid legal transaction (*Rechtsgeschäft*); second, a separate transfer of the obligation to a first third party and the mortgage (Eurohypothec) to a second one is alleged to place the borrower in a difficult situation, as he would then have to face two different claims. However, neither of both statements is true.

i. ***Causa* and accessoriness**. Elaborated in depth elsewhere,[25] Figure 1 shows those differences which exist between both: the *causa* refers to the obligation to create a security real right (or to use an already existing one) to guarantee an obligation/s (*pactum de hipothecando*: the obligation of the mortgagor to create or employ a mortgage to guarantee certain obligation/s) while the accessoriness, although there are many types, refers to the link and grade of dependency between the security right and the obligation/s, that is, what happens to the security right when the obligation is transferred, diminished, or extinguished.

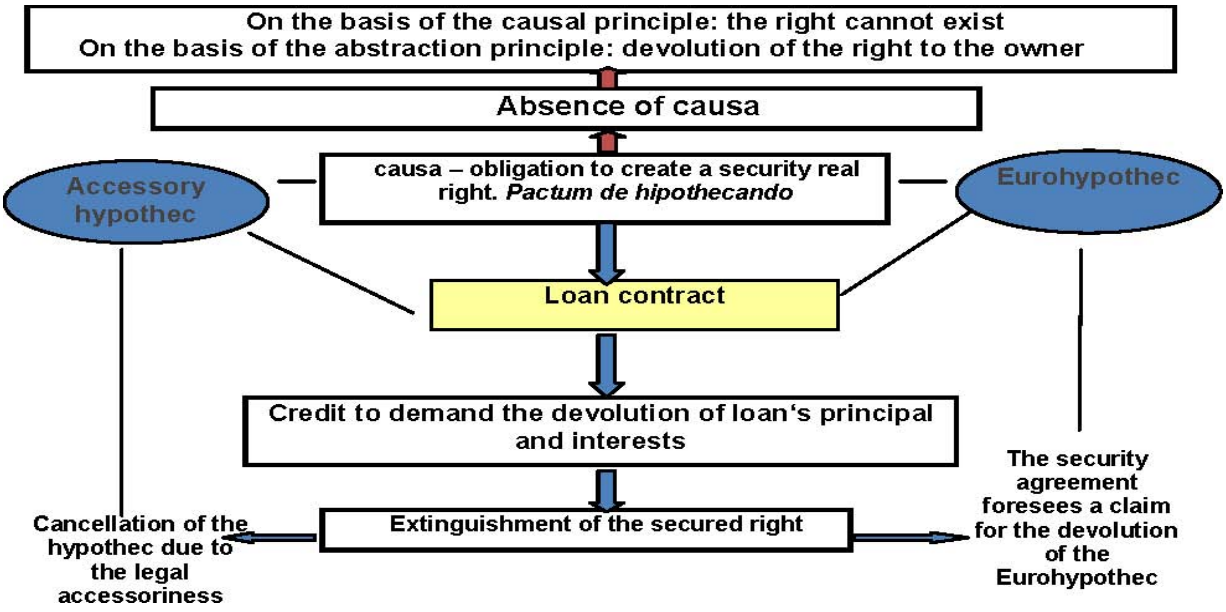

Figure 1. Causa and accessoriness.

ii. Risk (for the borrowers) of a **separate transfer** of the mortgage and the loan. Although this may be possible only if agreed between the borrower and mortgagor in the security contract, it would be necessary in some way to allow a Euro-securitization process through a Eurotrust,[26] that is, the secured loan

25 See Nasarre Aznar, Sergio and Stöcker, Otmar, *Un pas més en la „mobilització de la hipoteca: la naturaleza i la configuración jurídica d'una hipoteca independen*t, „Revista Catalana de Dret Privat", Vol I, 2002, Barcelona, 2002.

26 See below.

alone should be able to be transferred to a Special Purpose Vehicle (SPV) – that which issues the MBS – while the Eurohypothec itself would be held by the original mortgagee on trust for the SPV. Therefore the normal case would be that the original mortgagee would retain the Eurohypothec and would only transfer the loan for mortgage funding purposes, and this is what would be agreed between the mortgage loan parties. However, it is possible that the original mortgagee transfers the loan to a first third party and conveys the Eurohypothec to another, although this can be agreed against in the security contract; but in case it has been not, this situation may compel the mortgagor to face two possible claims (one from the transferee of the claim an the other from the transferee of the Eurohypothec). See the scheme in Figure 2.

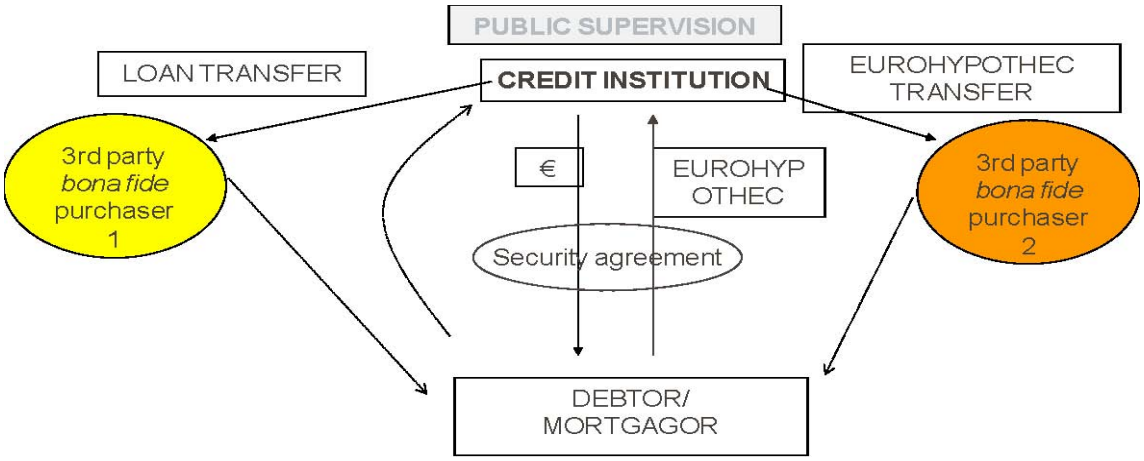

Figure 2. Debtor's risk facing two claims: from the lender and from the mortgagor

However, the debtor/mortgagor would be able to use all pleas and exceptions to protect himself (see Basic Guidelines 2005), especially, that which states that he has already paid the loan, so he can stop the enforcement of the Eurohypothec. In any case, he would not have to pay twice and states should ensure this by any mechanisms (either legal or contractual).

– A third criticism builds on the argument that **many different fields of law would become affected**. Whilst this is true, it should however be noted that the necessary changes would be carried out spontaneously by national legislators to improve their national forms of Eurohypothecs. If a jurisdiction has a defective enforcement system that prevents speedy full recovery of the borrowed amount to the lender, few or more expensive (higher interest rates and worse conditions) Eurohypothecs would be granted in that country when compared with other jurisdictions with better enforcement procedures. The same would happen with the insolvency context, the efficacy of the Land Register and all "soft law" that has been explained in the previous point, letter E.

– A forth query refers to the **scope of the Eurohypothec**: Should it be allowed only in the context of international transactions or also in domestic operations? Nothing should restrict the use of the Eurohypothec in domestic operations, if it would produce beneficial results for the parties involved. It should be presented as another option to them, separate from their national security rights on real estate. Should it be applicable only to professional lenders or also to non-professional lenders? This argument is not surprising to see in several national jurisdictions in which some security rights are only recommended for professional and controlled use (like the *Grundschuld* in Germany) or even legally limited to their use (the new *hipoteca recargable* in Spain). In principle, the desirable scope of the Eurohypothec should be as wide as possible, but this question, too, could be left to national parliaments.

– Fifth, one might ask whether the EU has the legislative**competence** of the EU to implement a Eurohypothec?

Under primary legislation, it is clear that the Eurohypothec is linked to the free movement of capital and people, which nowadays can only be achieved by an action of the EU, to which it is legitimated by art. 3b.3 EU Treaty. While the reference to free movement of capital is rather clear (trans-national active and passive mortgage operations will result in a Paneuropean movement of capital in relation to real estate), that which refers to people, implies the possibility of people easily financing their houses in another EU country from a national bank, not only for second-residences but also for geographical mobility of workers. They would be able to plan their movements abroad thus contracting with their national banks (theoretically with better conditions) in matters relating to the financing of their new house abroad.

The specific references in the Treaty of the European Union last amended by the Treaty of Lisbon 13-12-2007:[27] Art. 2.2 (freedom of movement and residence), internal market and economic union (arts. 2.3 and 2.4) and art. 6.1 which gives the Charter of Fundamental Rights of the European Union of 7-12-2000[28] last amended on 12-12-2007[29] the same legal value as the Treaties. In fact, it is this Charter that refers to the fundamental rights of property (art. 17.1), familiar, home and private life (art. 7), consumers' protection (Art. 38), help to families (art. 33.1), free movement and residence (art. 45), free movement of workers (art. 15) and, in general, the Charter of Rights seeks the "free movement of persons, services, goods and capital, and the freedom of establishment" (Preamble).

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27 Official Journal the European Union, 2007/C 306/01, Vol. 50, 17-12-2007.
28 Official Journal the European Union, C 364/1, 18-12-2000.
29 Official Journal of the European Union, C 303/15, 14-12-2007.

In order to avoid too much intrusion in national laws, consideration of the application of the Eurohypothec as a "28th regime" seems to be a feasible solution.

The role of the **trust** in several civil law contexts is still in doubt. As we will see in the next part, the Eurotrust is an essential complement for the Eurohypothec.

II. The Eurohypothec and the Eurotrust

1. Introduction

Many financial operations do not take place internationally because they are too complex, expensive or, simply, impossible. The reasons may vary, but many of them are related not only to the lack of a common mortgage instrument in Europe (credit institutions do not wish to face the risk of granting a mortgage that implies the application of a foreign law, according to the applicable *lex rei sitae*), but also due to the lack of an instrument that would provide clear and simple structures in many mortgage operations: a pan-European fiduciary instrument, which may be called "Eurotrust".

Broadly speaking, in many possible businesses with the Eurohypothec the trustee would be the holder of the Eurohypothec and the beneficiaries would be those lenders whose credits would be fiduciary secured by that Eurohypothec, thus avoiding many costs, time and legal complications. In the following points the concept and the uses of the Eurotrust are explained in more detail.

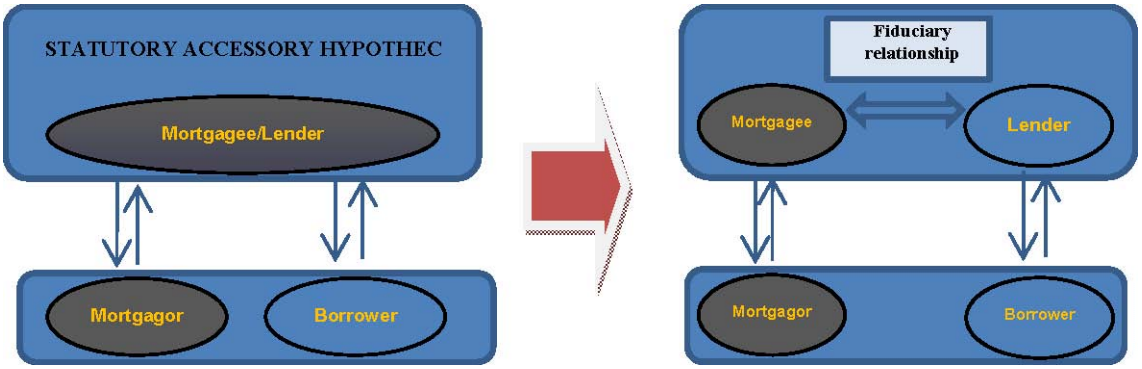
2. Concept of the Eurotrust

Although possibly with a misleading denomination (the Eurotrust is not related to the international Trust of The Hague Trust Convention 1985, but uses the term "Euro" because of its close relationships with the "Eurohypothec", and the term "trust" because it entails both obligational and real (fiduciary) effects, that is the isolation of assets from their holder), the Eurotrust has been conceived[30] as a **complement to the Eurohypothec**. This is so because the Eurohypothec, as a result of its legal nature as a contractually dependent real charge, is rendered more effective by the Eurotrust. It is a means of achieving

30 It was first referred to in Nasarre Aznar, Sergio and Stöcker, Otmar, *Eurohypothec and Eurotrust. Future Elements of a Pan-European Mortgage Market*, at „Innovation in Securitisation. Yearbook 2006", Jan Job de Vries Robbé and Paul Ali (coords.), The Hague, 2006, Ed. Kluwer Law International.

greater **flexibility** in the link between credit and mortgage, allowing the fact that lender and mortgagee could be different persons, **without losing security**.

Figures 3 and 4 illustrate how lender and mortgagee could easily be different people thanks to the Eurotrust.



Figures 3 & 4. Legal and fiduciary relationship between lender and mortgagee.

As a result, the Eurotrust would prove beneficial to any business requiring an efficient division between loan and mortgage :

Active operations: all those relating to the existence of several lenders under the same Eurohypothec

- **Partial redemption** of loan A and new taking of loan B (see White Paper 2007, p. 5, about the desire to improve consumers' mobility among lending institutions)
- **Total redemption** and **reuse** of Eurohypothec without loan (see the same idea at White Paper 2007, p. 5).
- **Syndicate mortgage lending.**[31]

Passive operations:

- The acquisition of mortgage loans European-wide for purposes of pooling them to issue **covered bonds** (art. 22 UCITS Directive) or simply **using other credit institutions' mortgages** (held on trust) to secure one's covered bonds issuances (see White Paper 2007, p. 3).
- Creating international pools of mortgages for **securitisation** purposes

In consequence, the Eurotrust combined with the Eurohypothec allows for the restructure of all businesses (useful for lenders and borrowers) that involve a **split between mortgage and loan**. Among **other uses** of the Eurohypothec

31 See its concept below.

itself due to its Paneuropean nature, it ensures that:

- During the obligation, the loan/s is **permanently secured by the mortgage held by another**, which is enforceable where the security agreement states so.
- In case **of insolvency of the mortgage holder**, the mortgage (Eurohypothec) should be treated as an **alien property** (and therefore not included in the insolvent's insolvency estate).

3. Uses of the Eurotrust

A) Ongoing syndication

This type of financial operation is commonly used to fund a project, which either entails an important grade of financial risk – ie. of default – or involves a huge disbursement of economic resources, or both. In these two situations, a single lender is faced with so many inconveniences in funding the project that he is simply not prepared to do it alone. Therefore, he requires the borrower/mortgagor to find – or finds by himself – other lenders that may be interested in sharing the risk/disbursement. If new lenders have entered the relationship since the beginning of the operation, it is called an "initial" syndicate lending. However, where those new lenders enter at a moment different from the initial one (when the financial operation was prepared), it is known as an "ongoing" syndication.

This difference is relevant to the usefulness of the Eurohypothec. Although it can be used in both situations, it is in the "ongoing" syndication where it plays a more important role, as it optimises this type of syndication or even allows it in legal contexts where it is not possible. Where it functions as an "initial" syndication, the operation can be organised through a common mortgage securing a loan in which the active side constitutes several lenders (joint and several credit). If nothing changes during the life of the project – that is, no new lenders come – the operation is properly structured. However, problems arise when new lenders come into the relationship – or where simply it was planned only for a single lender and a second or other ones are later added – who also want to be secured by the same mortgage. Ongoing lenders under a syndication are not comfortable when they are assigned second and further mortgages on the charged land. Depending on the concrete costs and in contexts where a split between mortgagee and lender is not possible (accessory mortgages), there are only two solutions, neither of which is optimal: either the mortgagor grants further mortgages to the newcomers – which makes the whole operation more expensive and even impossible, because this situation is

not desired by new lenders under a syndication –; or the first mortgage relationship is modified (novation) in the Land Register, which may involve, in some contexts, the extinction of the first mortgage and the creation of a brand new one (extinctive novation). However, even if it is only a modificative novation, the need for reformulation of the whole first mortgage loan, makes the operation more complicated and expensive.

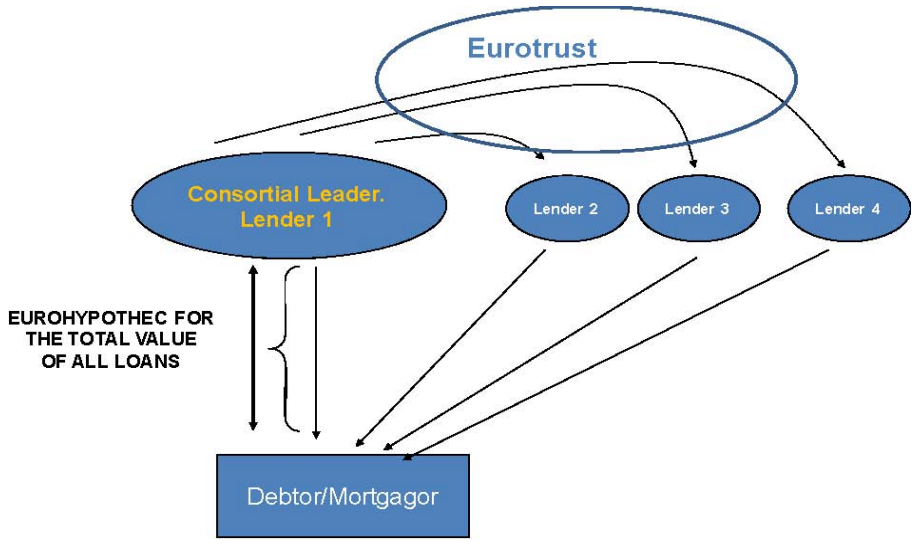


Figure 5. The syndication with the Eurohypothec & the Eurotrust

With the Eurohypothec and the Eurotrust, the ongoing syndication can be undertaken in an optimal way (see Figure 5 above): while the Eurohypothec allows for a split between mortgagee and lender, it is allowing the possibility of several lenders being secured by the same mortgage, either since the beginning of the relationship or in an ongoing syndication. However this is not enough, as no assurance is provided to the second and subsequent lenders that they are properly secured with the first single Eurohypothec with a simple contractual relationship between lender 2/3/etc. and the borrower and with another contract between lender 2/3/etc. and lender 1.

Because:

1) The "security contract" between lender 2/3/etc. and the borrower and lender 1, will only be enforceable between them, given the nature of a contract. Once lender 1 conveys the Eurohypothec, the assignee is not obliged to respect that contract (it does not affect him) and therefore, lender 2/3/etc. will no longer be secured by the Eurohypothec.

2) Even if lender 1 does not assign the Eurohypothec, the same problem can take place if lender 1 becomes insolvent and therefore the Eurohypothec will be included in his active estate. The same happens if lender 1 has re-

mortgaged the Eurohypothec (i.e. Sub-Eurohypothec) and a single enforcement is carried out by the owner of that sub-Eurohypothec. In both cases, lender 2/3/etc. will lose their contractual rights before the creditors of lender 1, who will be entitled to enforce or, (in case of insolvency) recover from, the Eurohypothec.

If the Eurotrust comes into play, it is now clear that the Eurohypothec is securing second and further lenders not only on the basis of an agreement between them and lender 1 and the security contact signed with the mortgagor, but also as a result of the agreement producing *erga omnes* effects, fiduciary effects through the fiduciary arrangement between lender 1 and subsequent lenders: from then on, the unaffected part of the Eurohypothec -that is, the part that has not been used to secure any loan at all, either because it never existed or because the mortgagor has partially repaid it- is going to cover lender 2/3/etc. although the Eurohypothec is still held by lender 1, both for himself -for the amount of his own loan- and for the other lenders –in amounts corresponding to each of the others' loans. This *erga omnes* fiduciary effect, will result in that part of the Eurohypothec that is securing other lenders' loans, being considered as an alien property, both in enforcement cases and, especially, in cases dealing with the insolvency of the first lender. In this latter case, the Eurohypothec will partially be conveyed to other lenders in most EU jurisdictions as it is considered an alien property, different from the property of the insolvent lender 1.

B) Preventing tying practices

One of the most interesting advantages that the Eurohypothec would present to borrowers is greater **freedom** -understood as a **de-link with a single lending institution** (in accordance to White Paper 2007, pp. 5, 9, 10 and 11) and the possibility of dealing with several of them at the same time (i.e. taking different loans from each one and securing all of them with the same Eurohypothec). This is in addition to other type of borrowers' tying: the geographical one.

a) **Geographical ties**. Because the Eurohypothec would help to create a true **Paneuropean mortgage market**, the **competition** among lending institutions would no longer exist only on a national basis but also at European level. With the development of new technologies, there are currently no restrictions or technical problems for consumers based anywhere in Europe in logging on to the internet, checking all mortgage offers offered by any European lending institution and calculating which is best for him, taking into account that the lending institution is willing and ready to grant the mortgage disregarding the location of the land that is to be purchased and used as security, thanks to the Eurohypothec. However, this is still not enough, because the lending institution should be aware of the physical and legal situation of the land, whose pur-

chase it is funding. This can only be achieved by the so-called "Euro-land register", which is not a reality yet, but where advances and work have proceeded on the already fully-functional European Land Information System (EULIS) project. As mentioned earlier, this project facilitates the possibility of checking cadastres and land registers of eight European countries through a single portal, EULIS, together with a thesaurus that tries to address terminological questions and definitions of charges in different jurisdictions.

b) The Eurohypothec should be seen as a **value on land**, that is, a means of negotiating with one's land value without conveying the land. The Eurohypothec, according to the Basic Guidelines, has been conceived more as value on land than as a charge. This conception implies in the first place that the Eurohypothec's negotiability should always remain in hands of the mortgagor, disregarding in whose hands the Eurohypothec is at different moments. This entails the possibility of disposal of the Eurohypothec by the mortgagor at any time, as soon as he has repaid the debt it had been securing. This can be concretized in three important aspects:

a. Complete subrogation

Regardless of the grounds (ie. the better the interest rates of the second lender, better treatment with other loans, etc.), the mortgagor – on the grounds of the special protection he deserves as a consumer (see, in this sense, White Paper 2007, p. 5) – should be able to change his lender, once he has repaid the first mortgage. Through the subrogation, Bank B pays the debt which the debtor/mortgagor has with Bank A with funds from the new loan it is granting the debtor/mortgagor in exchange of the mortgage he had granted the first lender. No change is required as regards the mortgage to ensure the complete success of this new operation. A private loan arrangement with the second lender is sufficient.

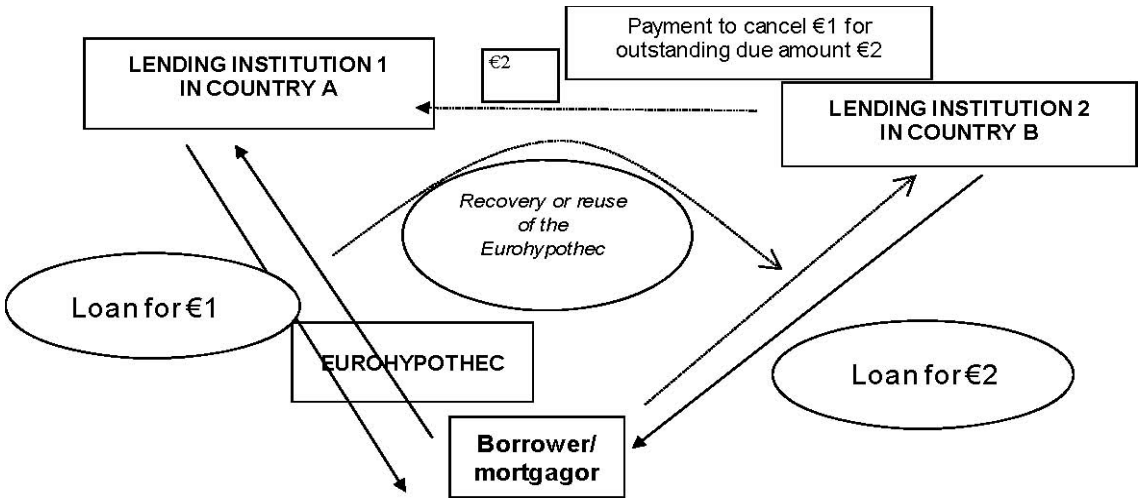


Figure 6. Scheme of complete subrogation of Bank B in Bank A

b. Reuse of the Eurohypothec by the borrower

Even when the borrower has fulfilled his obligations to the lender, the Eurohypothec is not extinguished (as it would under an accessory regime) and does not, therefore, need to be cancelled in the Land Register. Once the loan(s) is fully repaid, the mortgagor recovers the Eurohypothec and it does not consolidate with the ownership of the land, in conformity with what is usually agreed in the security contract. Instead, it can be kept by the mortgagor until he requires it once again for other purposes, such as the purchase of another house or to take advantage of credits for other purposes under the Eurohypothec, like loans for holidays, cars, etc. As a result, there is no need to cancel the first one and create a new one thereafter, thus saving time and money.

c. Reducibility and partial reuse

One of those rights of the mortgagor which illustrates the involvement of the Eurohypothec is exemplified in the possibility of reducing it whenever it is over-securing the loan in comparison to the over-collateralization that was agreed at the time the mortgage loan was granted (in relation to the loan-to-value ratio, LTV). That is, if the land is valued at €100, the mortgage on it may be arranged at, let us assume, €100 (therefore the land is charged for its whole value), while the loan would be €80, that is, with overcollateralisation of 20%. At the very moment the debtor pays the first instalment, the overcollateralisation is increased, which means that in practice, the lender is benefiting from an increasing overcollateralisation for free, without compensating the borrower who is witness to his land being increasingly and unnecessarily overcharged: if the lender had agreed to grant a loan of 80€ with a mortgage coverage of only €100, why should he be entitled after each instalment to be increasingly more secured (with an increased value of mortgage overcollateralisation) without any compensation for the borrower? These are overcollateralized loans (with a value, an asset, the mortgage itself, that in fact belongs to the mortgagor) from which the lenders are unduly making profits (unjust enrichment) i.e. with the issuance of mortgage securities. On this ground, several jurisdictions like Germany allow the mortgagor to unilaterally **reduce the mortgage** in the Land Register (like Germany, at §§ 1144 and 1145 BGB), while others forbid it on the principle that the mortgage is indivisible (i.e. in Spain, art. 122 LH).

According to rules of the Basic Guidelines which relate to the Eurohypothec, the mortgagor will therefore act with the released part of the mortgage according to the clauses in the security agreement: he would either cancel the mortgage partially in the Land Register or simply reuse it with the same or with another lender to secure another loan with him. Figure 7 shows this second possibility.

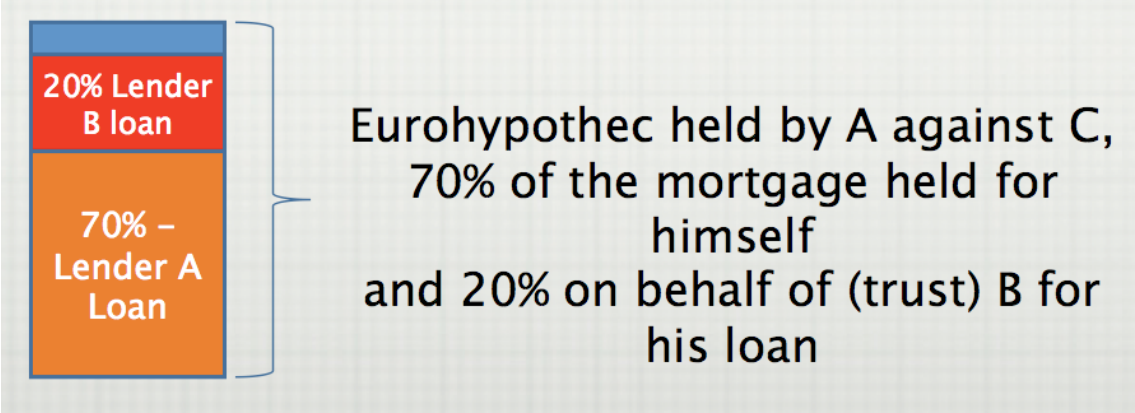


Figure 7. Partial cancellation and partial reuse of the Eurohypothec

C) Eurohypothec's securitization

Another benefit of the Eurohypothec to lenders is the creation of a truly pan-European mortgage securities' market, that is, the possibility of using Eurohypothecs from all around Europe as assets to be securitized on a European-wide basis. Instead of pooling a wide range of commonly unknown securities on land (ie. in Spain, apart from the so-called *participaciones hipotecarias*, which are securities that are unique in Europe and quite insecure from a legal point of view as they "financially simulate" the assignment of mortgages, no mortgages are pooled for securitization purposes; in France, mortgages are conveyed only through a so-called *bordereau de cession*; in England, equitable mortgages are usually pooled;[32] in Germany, until 2005 with the creation of the fiduciary *Refinanzierungsregister*, no securitization was possible, resulting in uncertainty for investors (and this is necessarily one of the reasons why mortgage securitization is not done nowadays at Europea-wide level), a single and known mortgage instrument/security on land could be pooled: the Eurohypothec. Although at a second stage, Eurohypothecs granted in different countries would have different grades of risk, as mentioned, because of the legal environment in each jurisdiction – which includes factors such as the efficacy of the Land Register, the insolvency and enforcement regulations, etc. – the instrument would require acknowledgement from investors and they could demand a proper (and compensatory to risk) interest rate revenue, according to the amount of Eurohypothecs present in the pool coming from France, Germany, Spain, Poland, Romania, etc., whereby risks can be calculated (and compensated inside the

32 See Nasarre Aznar, Sergio, *Securitisation & mortgage bonds. Legal aspects and harmonization in Europe*, Saffron Walden (UK), 2004, Ed. Gostick Hall, for the *participaciones hipotecarias*, the *borederau de cession* and the equitable assignment of mortgages in the UK.

covering pool) accordingly.

Apart from creating such a Paneuropean securitization market ("Eurosecuritisation", it could be called), the Eurohypothec would help to develop and compensate housing and mortgage markets all over Europe. Thus, if a national mortgage market lacks liquidity (that is, its lending institutions have been caught in a "lending long-borrowing short" crisis), their liquidity would come from an international pool of Eurohypothecs – selling to them those credits secured by the Eurohypothecs – thus increasing the possibility of attracting foreign investors at better rates due to the risk compensation that would operate inside the pool, which would be created by Eurohypothecs from all over Europe (geographical risk diversification). See this structure in Figure 8.

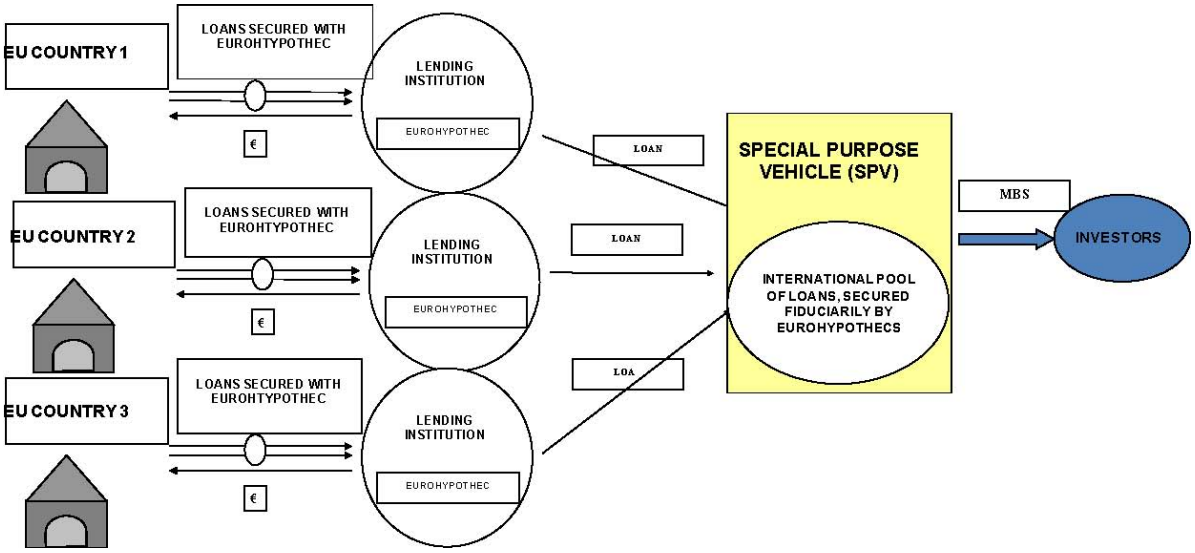


Figure 8. The Eurosecurisation

The Eurosecuritisation process is technically feasible with the Eurohypothec because the Eurohypothec allows, through the Eurotrust, a secure split of the lender from the mortgagee. A common problem for all securitisation processes in civil-law jurisdictions has been how to convey in a secure and efficient way, thousands of mortgage loans. The mortgages in those countries -this is also true for legal mortgages in common law jurisdictions and this is why an equitable transfer to the SPV is used – are extremely "heavy" to convey, in terms of time and costs. The Eurohypothec resolves this issue in a legally-friendly way (avoiding the conception of creatures such as the *participaciones hipotecarias* or the *bordereau de cession*)[33] allowing only the transfer of the secured loans -which can be achieved through a private contract – whilst, at the same

33 For comments, see Nasarre Aznar, Sergio, *Securitisation & mortgage bonds. Legal aspects and harmonization in Europe*, Saffron Walden (UK), 2004, Ed. Gostick Hall.

time, allowing the originator of the mortgage loans to retain the Eurohypothecs on trust (Eurotrust) for the SPV[34] (the new "lender" or owner of the loans). Thus, all loans owned by the SPV – the issuer of the mortgage-backed securities – are at every moment fiduciarily covered by their respective Eurohypothecs, still held by originators. This is especially relevant in cases where the originators become insolvent. In such cases, Eurohypothecs would consolidate with the loans within the jurisdiction of SPVs, as they would be treated as alien property (property of the SPV).

D) Using other credit institution's Eurohypothecs for issuing covered bonds

The most frequently used mortgage finance instrument in Europe is the mortgage bond (also known as "covered bond", when it includes funding of loans granted to public institutions). Although for its issuance, the transfer of the mortgage bond to any SPV is not required (unlike MBS, the default risk in covered bonds is assumed by the originator of mortgages, as covered bonds represent debt to them), the problem remains similar: there is no European mortgage bond market (issuance of covered bonds backed by mortgages granted over land in a foreign country) because of, first, the low trans-national mortgage lending and, second, the lack of trans-national mortgage transfer due to the "burden" of transferring mortgages (for the same reasons explained above) together with the uncertainty of the legal environment (directly linked to the efficacy) that surround each national mortgage. The Eurohypothec would banish all these doubts in relation to the legal working of mortgages in Europe while the Eurotrust would facilitate the easy transfer of mortgages, in the same way as has been explained above.

E) The multi-parcel Eurohypothec

The Paneuropean dimension of the Eurohypothec's most relevant example is the multi-parcel Eurohypothec, shown in Figure 9. Its main feature is reflected in its capability of admitting as security for a loan (or several loans), several pieces of land located in different EU countries.

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34 See footnote 10 above for the explanation of the SPV.

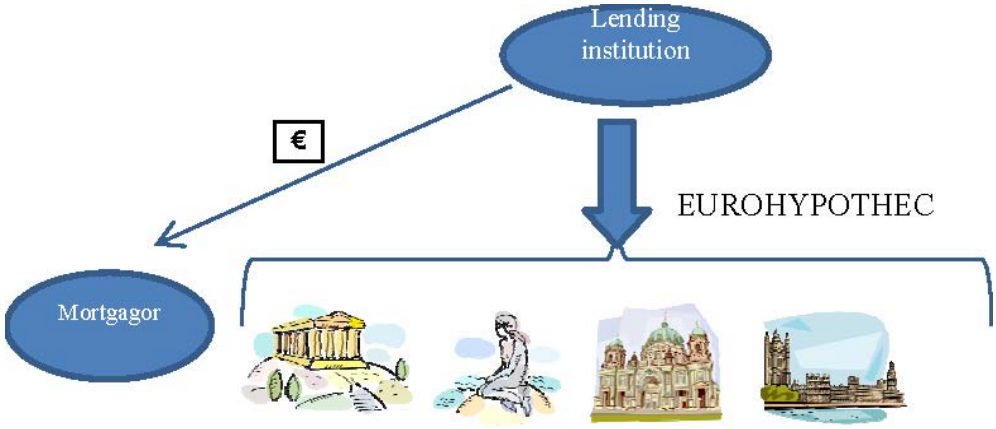

Figure 9. The Multi-parcel Eurohypothec.

III. Real case: Spanish mortgage reforms 2007

1. General overview of the Spanish mortgage reform 2007

Through Act 41/2007 7 December,[35] Spain has reformed its legislation on mortgages. It is perhaps, the biggest reform since 1946 and 1981, dealing with the two faces of the mortgage market: active operations (regulated in Mortgage Act 1946) and passive operations (regulated in Mortgage Market Act 1981). In relation to the first one, measures are taken to give more transparency to the mortgage lending pre-contractual and contractual information to the borrower; the Act wants to ensure the independence of the land valuation companies in order to avoid improper practices that have taken place the leas 10 or 12 years (some lending institutions have created their own land valuation companies to obtain valuations more adequate to their own interests); it also makes more transparent the mortgage loan pre-payment fees for borrowers; the notarial and land registrars' fees are reduced; and "updated" types of mortgages are regulated like the *hipoteca de máximo* or the *hipoteca recargable* (to allow more secure transactions with different loans covered with the same mortgage).[36] And in relation to the second one, another legal configuration is given to the Spainsh *bonos hipotecarios* (a useless mortgage security which I fear it would remain useless after the reform as they are deprived from their unique advantage in relation to the cédulas: their strong *security*) while the assets that can cover the *cédulas* are enarged (not only mortgages but also other liquid and secure assets).

35 BOE 8-12-2007, num. 294, p. 50593.
36 See below for more details.

But in any case, this reform should be contextualized in the light of a wave of reforms in the European context in relation to the improvement of the mortgage market: France (the already quoted *Ordonnance* 23-3-2006 for mortgages and the *Loi* 2007-211, 19-2-2007[37] about the trust (*fiducie*)) and Germany (GNBSR 2005[38]). It should be also understood in the line of improvements in national legislations following the publication of the Basic Guidelines 2005, which included the benefits of a Eurohypothec (uses that a Eurohypothec should be capable of).

As a starting point, it should be pointed out that the Spanish mortgage reform has improved, in the way already seen (more flexibility for mortgage lending and with mortgage securities), Spanish mortgage efficiency both in active and in passive operations. Yet, in the light of what has been said so far, further improvements would be necessary to meet the goals proposed by the White Paper of 2007:

a) Greater flexibility for lenders

In this sense, Spain offers not only the possibility of creating a mortgage to secure lines of credit (art. 153 LH), but also that of creating a rechargeable mortgage (art. 13.2 Act 41/2007). While these instruments are not yet present in every European jurisdiction (i.e. Romania and Bosnia), the Eurohypothec would make this a possibility.

b) Greater flexibility for borrowers

i. The possibility for borrowers to change their lending institutions in a reasonable cheap way has been a reality in Spain since Act 2/1994 (art. 2). However, the Reform of 2007 has limited this possibility in an important way, following the Resolution of the Spanish High Court 25-11-2003, which is commented on below. As a result of the reform, mortgagors are no longer able to change their credit institution if the first credit institution makes the same offer as the second one. As long as the reasons provided for changing credit institutions would be of any type (i.e. the first one has denied the borrower an extra loan while the second one would grant it to him), this is an important new limitation to mortgagors' rights, which goes against what would be desirable in the whole of Europe. In the context of this new situation, borrowers could be tied to the same lender for as long as such lender would like to retain him, taking into consideration that all further loans must necessarily be granted by the same lending institution if the borrower wanted to cover them under the mortgage,

37 JORF 21-2-2007.

38 *Gesetz zur Neuorganisation der Bundesfinanzverwaltung und zur Schaffung eines Refinanzierungsregisters 2005* (GNBSR), BGBl 27-9-2005, Part I, pp. 2809-2819.

as the Spanish mortgage does not allow the separate co-existence of lender and mortgagee. The high costs of changing a mortgage lender, in situations beyond the scope of Act 2/1994, would discourage the borrower from changing the original lender.

ii. In relation to the possibility of partial reuse of the mortgage, Spain does not allow it on the basis of Arts. 668.3 LEC and 236f.4 RH.

c) Eurosecuritisation and efficient systems of mortgage transfers

Because the nature of Spanish *participaciones hipotecarias* has not been altered and clarified, the Spanish Mortgage Market Reform 2007 has not helped to achieve the so-called Eurosecuritisation.[39] In relation to an efficient – and of course, civil law-friendly – system of mortgage transfer, this has even been worsened following the introduction of the Spanish Reform 2007, with the new redaction given to art. 149 LH by art. 11.3 of Act 41/2007.

Until the reform, it was clear to jurisprudence that none of the requirements established in art. 149 LH (giving notice to debtor, notarial deed and registration in Land Register) were necessary for the operation of a mortgage loan conveyance, disregarding the misleading redaction of that article; therefore, the redaction of art. 149 LH was afforded more flexibility. However with the new text, the legislator introduces yet again the word "*deberá*" (must) which implies that any transfer of mortgages must be carried out through notarial deed and registration. The problematic unnecessarily returns.

a) *Free mortgage loans' syndication*. Because of the legal accessoriness of the Spanish mortgage, even after the reform of 2007, efficient (without altering the mortgage) and ongoing syndications are not possible.

b) *A Euro-Land Register, together with a Paneuropean recognized title to register*.The Spanish mortgage reform: 1) does not allude to any possible step forward the European integration of Land Registration services; 2) it does not try to prevent resolutions like the RDGRN 2-7-2005 (explained below) that prevents the efficacy of foreign notarial deeds in Spain, which goes against the European law; and, finally, the reform does not support the incorporation of Spain to EULIS. As can be seen, the White Paper 2007 explicitly supports the Project EULIS (p. 8) and for 2008 a recommendation on land registration is expected (p. 11).

c) *A Paneuropean mortgage solution*, merely based on the title of the White Paper 2007: "Integration of EU Mortgage Credit Markets" and the requirement that any change should lead to the creation of new opportunities for cross-

39 See the problematic at Annex 3 White Paper 2007, p. 167.

border mortgage activity. The Spanish reform is not thinking in pushing forward the integration of the European mortgage market, which is not acceptable for a piece of legislation which has been elaborated in a parallel way to the EC White Book 2007.

Europe demands (including White Paper 2007)	Spain (Mortgage Act 1946, Act 2/1994 and Act 41/2007)	European panorama	Eurohypothec (Basic Guidelines)
+ LENDER'S FLEXIBILITY	**Lines of credit:** yes, (art. 153 LH) **Recharchable mortgage:** yes (art. 13.2 Act 41/2007 that modifies art. 4 Act 2/1994)	Not a reality in every country (Romania, Bosnia)	Possible, without restrictions
+ BORROWER'S FLEXIBILITY	a) **Subrogation**: yes, but with limits (art. 2 Act 2/94) b) Partial or complete **reuse** of the mortgage: no (arts. 668.3 LEC and 236f.4 RH) c) **Reducibility**: no (art. 122 LH)	a) **Subro**.: no in Ukraine, Russia, Poland b) **Reuse**: no in Russia, Romania c) **Reduc**.: yes in Germany (§§ 1144 y 1145 BGB)	Possible, without restrictions
EUROSECURITISATION AND EFFICIENT TRANSFER OF MORTGAGES	a) **Fiduciary transfer of mortgages**: no. Important legal disruptions. b) **Massive transfer** of mortgages: too strict and even worse in Act 41/2007 (art. 1528 CC; art. 11.3 Act 41/2007	a) Only possible in Germany (2003), Estonia, Hungary, Romania and Slovenia. Equity solution under common law jurisdictions. b) Very flexible in Switzerland, Germany or common law jurisdictions	All possible, without restrictions. Moreover: multi-parcel Eurohypotec
FREE MORTGAGE LOANS SYNDICATION	Only initial; not possible efficient ongoing syndication	Only possible in Germany, UK, Denmark, Switzerland, Estonia and Sweden	Possible, without restrictions
EUROLANDREGISTER	Good Land Registry system (on-line consult through www.registradores.org, digital signature); but not in EULIS	- Some countries are in EULIS - Others have no computerised Land Registry (Bosnia, Ukraine, Romania) - Others, e-conveyancing (UK)	Fully compatible with EULIS
A PANEUROPEAN MORTGAGE SOLUTION	Most of the solutions that may suit under Spanish law may not suit under other countries' law (ie. Lack of notaries)	Countries tend to find "national" solutions, disregarding international mortgage business	The Eurohypothec facilitates a true European mortgage market

Table 2. Eurohypothec, new Spanish mortgage and European panorama

2. Comparisons between the Spanish mortgage reform 2007 and the Eurohypothec

Although mortgage credit relationships between the same lender and same borrower have been optimized (ie. rechargeable mortgages), none of the businesses that require a split between the mortgage and secured obligation can be

undertaken under the Spanish mortgage system or can be undertaken efficiently, as can obviously be undertaken by employing the Eurohypothec and in those jurisdictions where the link between mortgage and secured loan is not legal. These are the conditions for financial operations like securitization, the massive trans-national transfer of mortgages and the syndication on mortgage loans.

In addition, the Spanish reform does not provide an optimal solution for borrowers under Spanish jurisdiction, as they are permanently tied to a single lender (which is regarded as a bad praxis by the White Paper 2007), without an easy way of changing lenders or including another into the first's mortgage rights to obtain more advantageous loans. In fact, the land of the mortgagor is over-indebted following the first payment of the mortgage instalment as there is no possibility of unilaterally reducing its amount in the Land Register, while the mortgagor has no possibility of reusing the mortgage once he has repaid the full loan. Both the jurisprudence of the Spanish High Court (STS[40] 25-11-2003) and the administrative organ that decides the recourses against decisions of Notaries and Land Registrars (the DGRN[41]; see the Resolution DGRN 21-7-1995), and Art. 13 of the Mortgages' Reform Act (which replaces art. 2 Act 2/1994) have misinterpreted the function of Act 2/1994 (on the contrary, see a more appropriate interpretation at AAP[42] León 24-2-1998, which considered that changing the lender should always remain in the hands of the debtor without further restrictions; see also art. 1211 CC), which tried to give more dynamism to the mortgage market. Since the new Act has come into force, the borrower no longer has the right to freely change his lender and can only do so if he is offered better conditions for the mortgage loan, with the possibility of the first lender matching these conditions. If this were to be the case, the borrower would have to stay with the first lender, disregarding the reason for changing the lender (ie. better treatment, concession of further loans, etc.).

Moreover, the DGRN still operates "in a Spanish way", vetoing deeds produced by notaries' from other European countries to be registered in the Spanish Land Register for land conveyance or other land-related operations, through the RDGRN 2-7-2005.[43] However, more than a year later, this Resolution has been found to be void and against not only EU principles, but also

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40 *Sentencia del Tribunal Supremo*, Spanish Highest Court Resolution.

41 Dirección General de los Registros y del Notariado

42 Auto Audiencia Provincial, Order of a Court of Appeal

43 A similar situation took place several years ago during the registeration of a Swiss Notary title in Germany. This incident was also heavily criticized by the pro-European doctrine (Heinz, Volker G., *Beurkundung von Erklärungen zur Auflassung deutscher Grundstücke durch bestellte Notare im Ausland*, „RIW", 12/2001, p. 928).

against the Rome Convention 1980 by SAP Santa Cruz de Tenerife 22-11-2006.[44] Perhaps the creation of a common database in every EU Land Register – the Eurotitle[45] – would be advisable to avoid such problems in the future. Obviously the Eurotitle would serve as a good complement for the Eurohypothec.

And finally, while several mortgage-related topics have been addressed by Act 41/2007 with greater or less success, it has not addressed crucial needed reforms in relation to mortgage securities[46] (*cédulas hipotecarias* – Spanish covered bonds –, *bonos hipotecarios* and *bonos de titulización hipotecaria* – Spanish mortgage-backed securities, MBS-, essentially). Along with legal structural problems that still persist: legal nature of their guarantee, it constitutes an even worse regulation for covered debts (*bonos hipotecarios*). Moreover, inaccuracies in regulating the covering Register (in German *Pfandbriefgesetz* this is referred to as the *Deckungsregister*), lack of the fiduciary (the *Treuhänder* in Germany), uncertainties in their behaviour in insolvency proceedings, etc. still exist. On contrast, as seen previously, the Eurohypothec would allow for the so-called Eurosecuritisation while the Eurotrust would facilitate the massive transfer of mortgage loans on a trans-national level, bringing to the European mortgage market more efficiency and dynamism.

IV. Conclusions

1. **National regulations** for mortgages are being reformed to make them more flexible, following the introduction of the concept of the Eurohypothec but without Paneuropean awareness. The White Paper 2007 could possibly help push forward a true harmonization of the European mortgage market.
2. The **Eurohypothec** of the Basic Guidelines 2005 is fully compliant with the objectives of the **White Paper 2007** (p. 13): it enhances "competitiveness and efficiency of EU mortgage markets which will benefit consumers, mortgage lenders and investors alike"; it demonstrates its ability to create "new opportunities for mortgage lenders to access other markets and engage

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44 See the vision of a Spanish Notary at Rivas Andrés, Rafael, *Notas sobre la recepción en España de poderes extranjeros no formalizados en escritura pública*, "Notarius International", 3-4/2005, pp. 293 to 300.

45 Ploeger, Hendrik, Nasarre Aznar, Sergio and Van Loenen, Bastian, *EuroTitle: A Standard for European Land Registry. Paving the Road to a Common Real Estate Market*, „GIM-International. The Global Magazine for Geomatics", December 2005, vol. 19, num. 12, pp. 34 to 37.

46 See above, footnote 10 for the concept of mortgage securities.

in cross-border activity"; it enables "a more efficient mortgage lending process"; it leads "to improved product diversity and, potentially, lower prices for consumers"; it improves "consumer mobility through increased transparency and reduced product tying"; it enhances "market transparency, greater certainty [...] and a broader range of investment opportunities as a result of enhanced product diversity both within primary and secondary markets". However, whereas the White Paper 2007 refers to future "main tasks or activities" (essentially to organise specialised groups and to organize further studies without any link in common), it does not specifically mention the Eurohypothec, which raises the doubt: how will the EU achieve the already mentioned objectives without the Eurohypothec? These segmented activities (p. 14) are obviously not enough to achieve a true European mortgage market.

3. To create a true **Paneuropean mortgage market**, a Eurohypothec is needed – probably the model of the Basic Guidelines – which should be as secure, useful and flexible as possible, both for lenders and borrowers
4. The **Eurotrust** is a needed complement to the Eurohypothec in order to facilitate all types of fiduciary mortgage operations.
5. Other partners for the Eurohypothec would be **EULIS**, the **Eurotitle** and the possibility of establishing a true mortgage **Eurosecuritisation**.

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