Core principles for a mortgage law

EBRD Core Principles for a Mortgage Law

The principles are drawn on the assumption that the role of a mortgage law is economic. It is not needed as part of the essential legal infrastructure of a country: its only use is to provide the legal framework which enables a market for mortgage credit to operate.

The principles do not seek to impose any particular solution on a country – there may be many ways of arriving at a particular result – but they do seek to indicate the result that should be achieved. As with any set of general principles of this nature they must be read within the context of the law and practice of any particular country and they do not aim to be absolute; exceptions inevitably have to be made.

1. A mortgage should reduce the risk of giving credit, leading to an increased availability of credit on improved terms.

The first principle is overriding: if the legal framework for mortgage does not lead to a reduction in the risk of giving credit and an increased availability of credit on improved terms, then there is no point in the law providing for mortgage at all. This goes to the basic assumption made by the EBRD on all its work on mortgage law reform. Every element of the legal framework should be analysed against this basic principle.

2. The law should enable the quick, cheap and simple creation of a proprietary security right without depriving the person giving the mortgage of the use of his property.

The second core principle relates specifically to creation. It is more prosaic than the first but it permeates many aspects of the law on mortgage. The trio of simplicity, speed and inexpensiveness is fundamental and ties in directly with the concept of legal efficiency: formal requirements should be kept simple and the costs low. Every cost, irrespective of who bears it, that is involved in the creation of mortgage detracts from the benefits that mortgage provides. Any delays or complexities translate into cost.

3. If the secured debt is not paid the mortgage creditor should be able to have the mortgaged property realised and to have the proceeds applied towards satisfaction of his claim prior to other creditors.

This principle is also at the core of the mortgage's economic purpose. The exact nature of the proprietary right that arises when security is granted has to be defined in the context of the relevant laws, but if it is to be effective it must link to the creditor's claim the remedy of recovering from the property given as security.

The mortgage creditor should maintain a prior claim on the proceeds of realisation of the property (subject to the right of any pre-existing, prior-ranking creditor).

4. Enforcement procedures should enable prompt realisation at market value of the mortgaged property.

What gives a mortgage its value, and therefore enables borrower and lender alike to derive benefit from it, is the confidence that it can be used, if necessary, to repay the creditor's claim. The greater the doubts of the creditor as to his ability to enforce or the conditions under which he would do so, the less will be the influence of the mortgage when he decides whether to lend and on what terms.

When a creditor comes to enforce he needs to be able to realise the property rapidly. Delays in realisation are likely to be a source of uncertainty and cost. The property should be realised at the same value as on any other sale in the market. Any surplus proceeds beyond those needed for satisfying the secured claim returns to the mortgagor, and there is no justification for penalising him by a realisation at below market value.

5. The mortgage should continue to be effective and enforceable after the bankruptcy or insolvency of the person who has given it.

The position against which the creditor most wants protection is the bankruptcy or insolvency of the debtor. Any reduction of rights or dilution of priority upon bankruptcy or insolvency will reduce the value of security. The validity of the mortgage should not be affected by insolvency (with the exception of fraudulent or preferential transactions or those carried out in the suspect period, but the same rules should apply as for other pre-insolvency transactions).

Any rules permitting a moratorium or reorganisation of the debtor's assets should aim to strike a fair balance between the interests of the mortgage creditor and other parties.

6. The costs of taking, maintaining and enforcing a mortgage should be low.

The mortgage creditor will usually ensure that all costs connected with the mortgage are passed on to the debtor. High costs of creation of mortgage (mortgage agreement, registration and so on) will increase the cost of borrowing and thus diminish the efficiency of the secured credit market. Enforcement costs will reduce the proceeds on realisation and will influence a mortgage lender's assessment of the value of his security. Simple and fast procedures for creating and enforcing mortgage will help to reduce costs.

7. Mortgage should be available (a) over all types of immovable assets (b) to secure all types of debts and (c) between all types of person.

This principle covers a multitude of issues that may arise from legal tradition, the way the law is applied and the needs of commercial reality. A mortgage should be available over all types of immovable assets. There is little justification to allow mortgage over some properties and not over others.

Similarly a mortgage should be capable of securing all types of debts, present and future, specifically or generally defined, that can be expressed as a money amount. Any physical or legal person (whether in the public or private sector) who is permitted by law to transfer property should be able to grant security over it to any other person.

8. There should be an effective means of publicising the existence of a mortgage.

Publicity is needed to ensure that any person can be alerted to the existence of the mortgage. When taking a mortgage the creditor will want to discover whether any pre-existing mortgages have a prior claim. And once his mortgage is created he will want to be sure that anyone subsequently claiming a right in the property is made aware of his claim. Without a reliable system for publicity a creditor is unlikely to have sufficient certainty in his rights in the mortgaged property.

9. The law should establish rules governing competing rights of persons holding mortgages and other persons claiming rights in the mortgaged property.

Certainty in his rights over the mortgaged property is key to the mortgage creditor. He needs to know what rights of other persons may take precedence over his right of mortgage, for example, other mortgages, tax liens, rights of occupation or rights of spouses, in order to be able to assess and value his security. The political or social justification for any right of a third party which dilutes or compromises the ability of the mortgage creditor to recover his claim out of the mortgaged property should be balanced against the loss of credit opportunity which may result.

10. As far as possible the parties should be able to adapt a mortgage to the needs of their particular transaction.

The law is there to facilitate the operation of the mortgage market and to ensure that necessary protections are in place to prevent the debtor, other creditors or third parties being unfairly prejudiced by the existence of the mortgage. Parties should be allowed wide contractual flexibility. There are few cases which justify the law, or the institutions that implement it, creating rules or barriers which limit the manner in which parties can structure their transaction, principally at directing the manner in which parties to secured credit should structure their transaction.

Mortgages in transition economies (link to no.6)
