

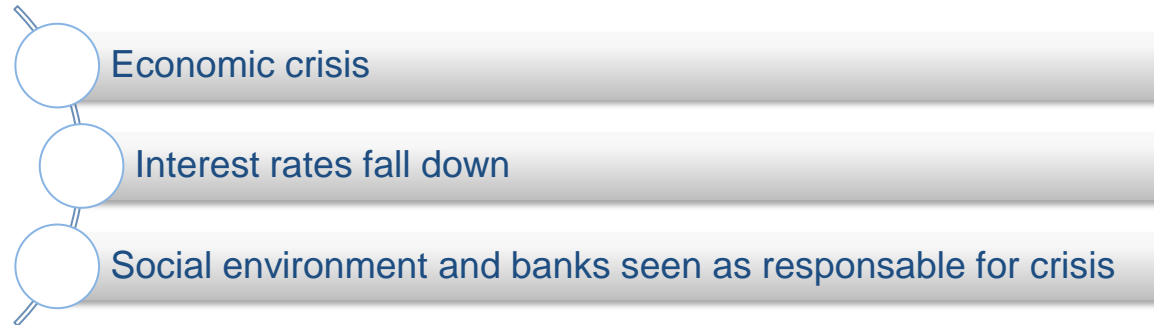
Judicial Process regarding floor clauses in mortgage loans

1

Introduction

1- Introduction

Background



- ❑ 2010: Clients' claims and lawsuits in relation to mortgage loans with floor clauses, as clients benefit from low interest rates **only** to a certain level
- ❑ They claim the floor clauses to be declared **unfair** and thus, **null and void**, and accordingly:
 - Banks to **remove** the said clauses from their agreements and to **discontinue applying** the floor when calculating the interest rate ("**cessation claim**")
 - and/or
 - Banks to **reimburse amounts** already paid, together with accrued interest (**retroactivity**)
- ❑ Both individual and collective actions

2

The situation in Spain

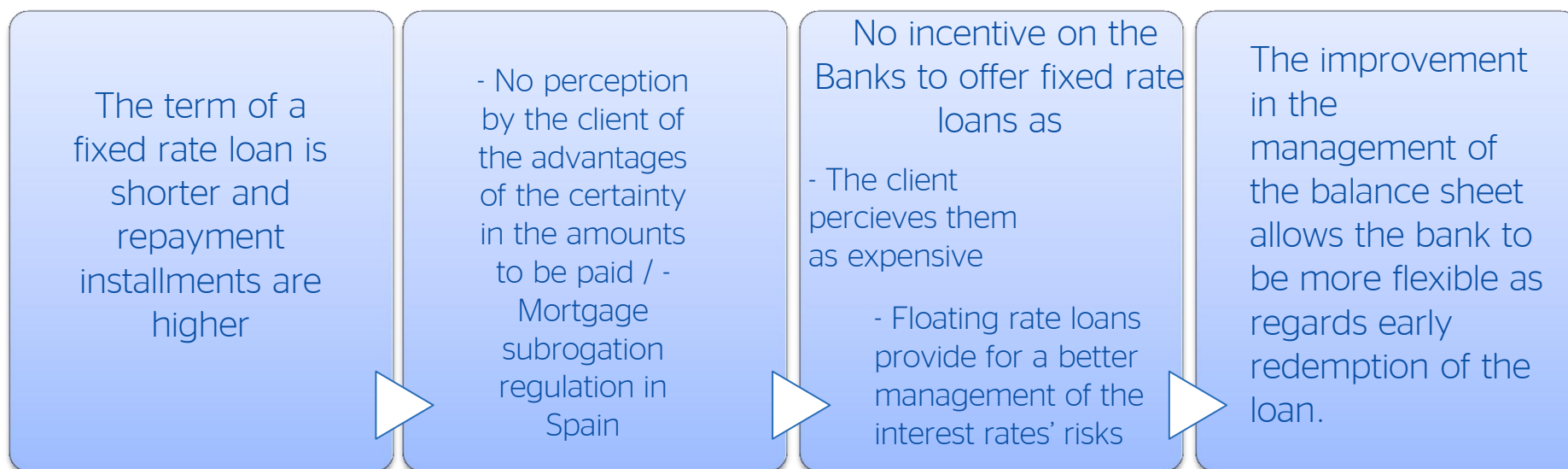
2.1.- Floor clause: concept

- The floor clause **limits** the **decrease** in the floating rate interest
- This clause determines the **minimum price** at which a Bank is willing to lend money to a client
- It is **not a “surprising” clause**: we see it in other types of agreements (water, electricity, telephone, insurance...)
- This limitation is part of the **definition of the price** of the loan (**essential element** of the contract)
- Plain and straightforward language, easy to understand

2.2- Economic data and role of the floor clauses

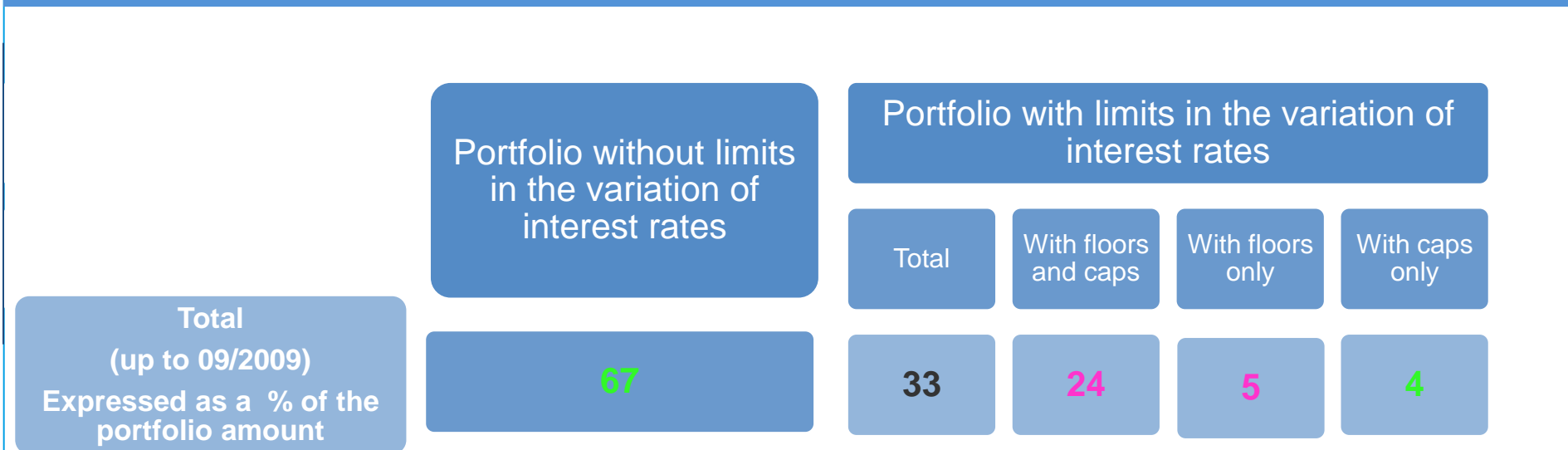
(Report of Bank of Spain as of May 2010)

- ❑ As of 31.12. 2009, nearly **97% of the mortgage loans** in Spain are **floating rate loans**
- ❑ **Why** do clients choose the floating rate option vs certainty of a fixed rate interest?



2.2- Economic data and role of the floor clauses

Chart 1 Distribution of the mortgage loan portfolio



- **71%** does not have any floor limitation in the interest rate calculation
- **29%** does have a limitation in the **decrease** of the interest rate.

2.2- Economic data and role of the floor clauses

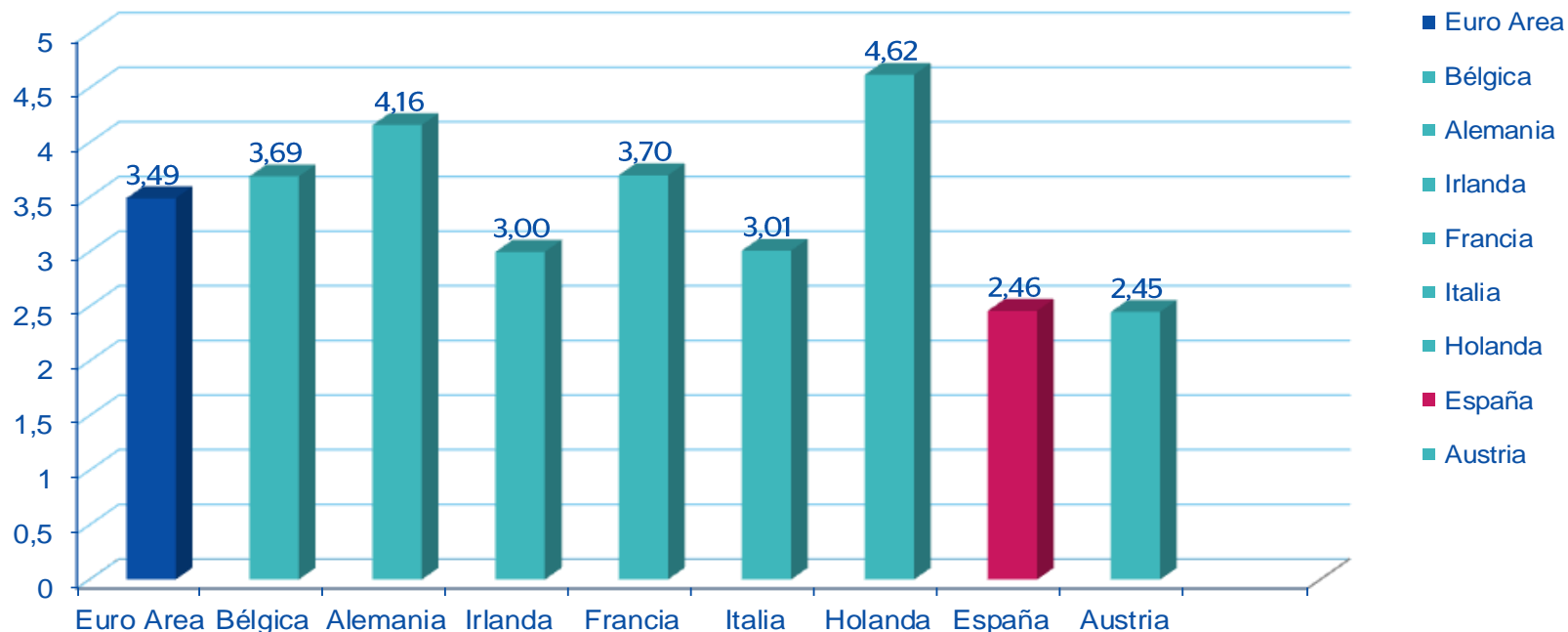
Chart 2

	Clauses with caps and floors		Only floors	Only caps	Euribor 1 year (annual average)
	Caps	Floor			
Weighted average (as of 9/09)	13,56	3,12	3,55	11,76	-
Granted in 2009	13,47	3,35	3,34	13,30	1,99
Granted in 2008	14,03	3,43	3,98	13,06	4,93
Granted in 2007	13,96	3,29	3,73	11,49	4,38

•Weighted average - low dispersion amongst entities: 2,75% [floor] 3,5%

•**3,12%**: under average cost of a mortgage in Europe.

**Chart 3 Comparative Spain / Europe
(Eurostat 2013)**



•3,49% represents the average cost of the outstanding mortgage loan portfolio in the States of the Eurozone

•Accordingly to Eurostat data: a) 3,14% was the average cost of the newly issued mortgage loans; b)The average interest rates for household mortgage loans in the period January - March 2011 was: 3% in Spain, 3,1% in Italy and Portugal, 3,6% in France and 3,9% in Germany.

•Taking into account the data published by the European Mortgage Federation regarding interest rates in 2011, in all Member States, the rates for newly issued loans during 2011 were higher than the floors incorporated in Spanish loans, except for Denmark.

2.2- Economic data and role of the floor clauses

Report of Bank of Spain - May 2010

ROLE

- Ensuring the **recovery** of the production and maintenance **costs** fo these financings: (i) cost o money and (ii) structural costs, which are necessary to produce and administer the loans
- Provide **stability** to the entitie's **results**, specially during low interest rates periods.
- Positive for the **stability of the financial system**
- Pursuing a criteria of **prudence**
- Allows for the **clients to better access** the housing market, specially on **a long term** basis

2.3- Legal Context

- “Floor clauses” have been **accepted** and **regulated** since many years in Spain
- Very **strict transparency rules** for residential mortgage loans, that guarantee the client’s knowledge of the limitation in decrease of interest rates **before subscribing** the relevant agreement
 - Ministerial Order as of 5/5/94 (no longer in force)
 - Ministerial Order as of 28/10/2011

Clauses expressly
regulated and licit

Special transparency
provisions



- The Client is provided with a “Binding offer”
- The Client is entitled to review the draft of the agreement in the Public Notary’s office (at least during 3 working days before signature)
- When floors and/or caps are stated, the Notary shall inform the clients about them

- **Directive 2014/17** of 4th February 2014 on credit agreements for consumers relating to residential immovable property: expressly refers to caps and floors when giving instruction to complete the “European standardised Information Sheet” (ESIS)

3

Some previous
concepts

3- Some previous concepts.

1 Directive 93/13 on unfair terms in consumer contracts

Art.3

- Contractual term NOT INDIVIDUALLY NEGOCIATED, **unfair** if:
 - Contra to **good faith**;
 - Causes significant **imbalance** in the parties' rights and obligations in **detriment of Consumer**

Art.4.2. Unfairness assessment shall **not** relate to **main subject matter nor adequacy of price, in so far as terms in plain and intelligible language**

Art.5 (...) terms must be drafted in **plain, intelligible language**

Art. 6.1. Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, **as provided for under their national law**, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.

2 Law 7/1998 on General Contractual terms

Art.1

General Contractual Terms (GCT) definition:

- Preestablished
- Imposed
- Plurality of agreements



Art. 5 and 7: Control of incorporation

- Does not analyze the legality of the clause as such, but rather clarity, concretion, simplicity
- Illegible, ambiguous, unclear and unintelligible clauses are NOT INCORPORATED

Art. 8 Invalidity

- General contractual terms that are unfair shall be null and void in agreements with consumers

3 Royal Law Decree 1/2007 Consumer's defense

Art. 80 Requirements for clauses NIN:

- Concretion, clarity, simplicity
- Accessibility, legibility
- Good faith and balance

Art. 82 Defines what an unfair clause is:

- Not individually negotiated
- Contra to good faith
- Imbalance in rights and obligations
- Detriments of consumers
- Unfair clause null and void

Art. 4.2 of Directive not incorporated into Spanish Law (but taken into account)

4

Lawsuits

4.1. 2010: AUSBANC (consumers' association) vs BBVA, Caixa Galicia and Cajamar

AUSBANC

- Floor clauses are **GCT**
- **Imbalance** in the parties' rights and obligations: the cap has never been reached. **Detriment of Consumer**
- **Lack of proportion**

 **Petition:**

- Floor clauses to be declared **unfair and thus, null and void** (because of imbalance)
- **Banks to stop using the said clauses (cessation)**

 **They do NOT:**

- **Question the legality or comprehensibility** of the clause (**transparency**)
- **Ask for reimbursement of amounts already paid**

DEFENDANTS

- Floor clauses are NOT GCT: they are an **essential element** of the contract and are negotiated. **Diversity of offers: client is able to choose and decide**
- **No imbalance**
- **Lack of similarity** between floor and cap is **not illegal**
- Bank of Spain states that floor clauses are positive for the stability of the financial system
- The Law is willing to control the legal imbalance, not the economic one
- **Economic imbalance is out of the Court's control**

**JM Sevilla
30/09/2010**

**Appeal and Public
Ministry (21/6/2011)
public interest**

**AP Sevilla
7/10/2011**

**High Court of
Justice (T.S.)
9/05/2013**

**Motion for
dismissal (not
accepted)**

**Rules against
Banks**

- Floor clauses are GCT
- They are not essential: floor is a “plus” in relation to the price previously agreed
- Diversity of offers and capacity for the client to decide do not imply they are negotiable
- Imbalance
- Only cover Banks
- They are null and void because not proportionate
- Lack of reciprocity

**Rules in favor
of Banks**

- Floor clauses are legal (but unfairness can be assessed)
- Floor clauses are not GCT: they are essential because they are price. They are not imposed
- Not contrary to good faith
- Borrower does not have a right to limit variability or proportionality of floor/caps
- Claimant has not proved what the disproportion between floor/cap is

**Rules against
Banks**

- One ruling is enough to create “case law”
- Has created a big controversy from the very beginning:
 - a) Conclusions of the ruling:
 - Clauses have to fulfill the “**substantive transparency**” test (no such provision exists in the current Legislation): **Court’s creation**
 - b) Irretroactivity

High Court of Justice Ruling: 9/05/2013

a) Floor clauses are CGT

- **Prestablished**: predrafted, not the result of a previous discussion
- **Imposed** by one party → the consumer can only either:
 - enter into the agreement by accepting the clause, or
 - not sign the contract
- **Plurality** → same terms in multiple agreements

b) Floor clauses are an “essential element” of the contract (part of the **price**), which does not mean they are not CGT

c) Can the “unfairness assesment” be made in relation to the “**main subject matter**” (art. 4,2 Directive 93/13)?

Art. 4.2. Directive 93/13 states that: “Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract not to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplies in exchange, on the other, **in so far as these terms are in plain intelligible language**”.

Resolution of High Court of Justice in Spain: the jurisdictional control does **not** extend to the adequacy of price and remuneration, **the unfairness cannot be assessed in relation to those matters**

However, the High Court of Justice (TS) states that, even if the unfairness assessment cannot be made in general terms, **the said clauses are still subject to a double transparency control**.

High Court of Justice Ruling: 9/05/2013

d) Controls: do clauses satisfy **the transparency controls?**

1) Control of incorporation

- Information provided in advance (binding offer, Notary...)
- Comprehensive, clear, concise and simple



Consumers are aware of the existence of the floor

- Easy to understand, as well as the consequences of it. No ambiguity

2) “Material Transparency”

- Consumer has to have a complete control and understanding of the price so that he is able to choose
- Need to understand how the floor can affect the “economy of the contract”
- Clauses cannot be hidden amongst other information
- “Surprising” clauses: loan transformed into a fixed rate loan. The offer as a floating rate interest loan is misleading contradicts expectations from customers
- Including floors + caps is confusing for consumers
- No scenarios simulation in relation to interest rates evolution are included
- No information as to comparative cost with other offers
- No “reinforced” communication (not highlighted clause)
- Insufficient information as to the fact that the floor forms part of the price

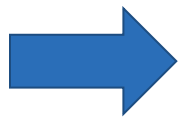
**No
legal
basis**

“Internal Rule”, not deriving from Directive 93/13. “Creation” of Spanish High Court of Justice. Also adopted later by CJEU.

High Court of Justice Ruling: 9/05/2013

e) Consequences of lack of transparency

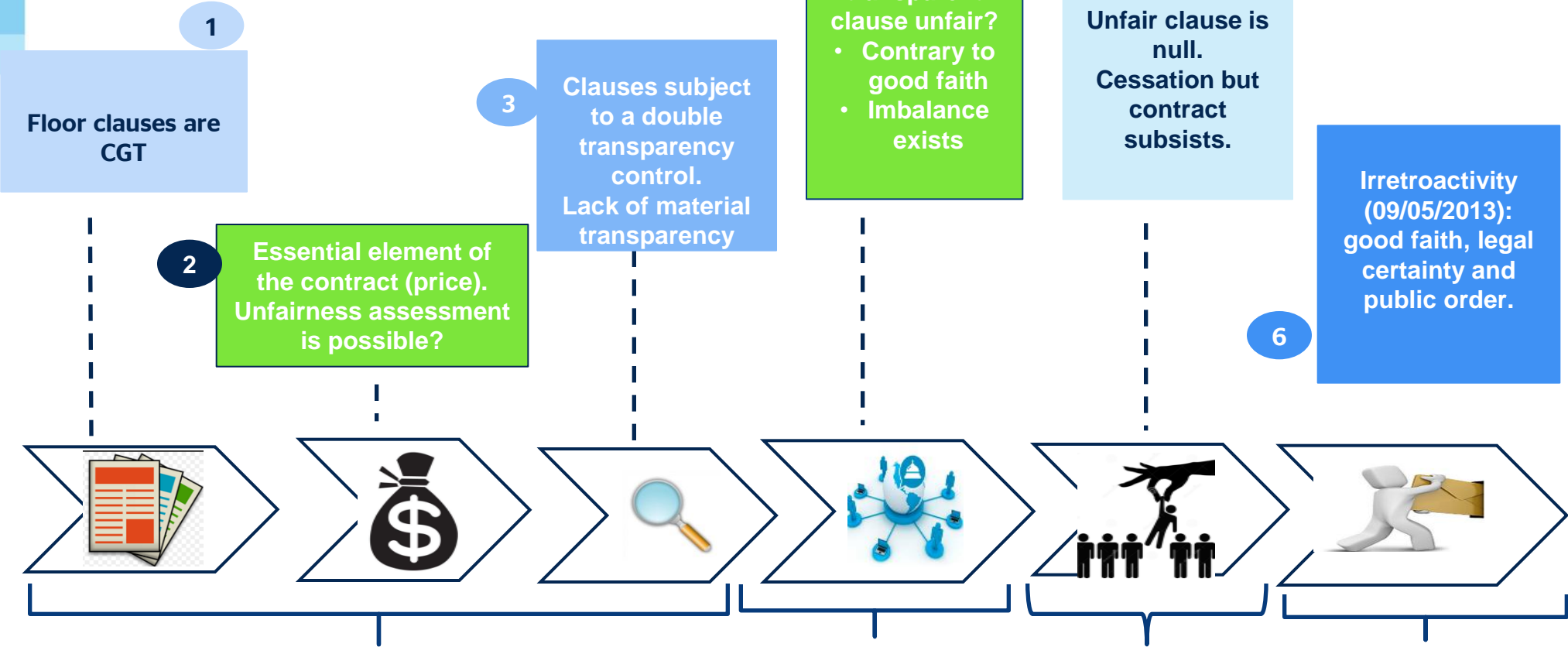
- Can the clauses which are not “transparent” be considered unfair clauses?
- **Unfair** clauses are defined as $\left\{ \begin{array}{l} \text{Contrary to good faith} \\ \text{Causes significant imbalance in detriment of consumer} \end{array} \right.$
- Can they be considered as creating a significant **imbalance**? **YES** because:
Imbalance cannot be interpreted on a **limited** basis
 - Frustrated expectations (floating rate interest which becomes a fixed one)
 - Impossibility of comparing the cost in the market → not possible to make a clear assessment of the real impact on the economic situation for the client



The Court declares the floor clauses to be UNFAIR, thus NULL and void: floor clauses (the ones used in this collective action by the relevant defendants) not to be used in the agreements (which are still in force). Applicable for ALL their consumer clients

- BUT the Court accepts the existence of GOOD FAITH (so according to TS both requirements are not cumulative)
- e) Irretroactivity: based on **good faith, legal certainty and risk of serious consequences for the economic public order (existence of some resolutions of the European Court of Justice)**. And additionally clauses are licit, information was provided according to applicable Law, obligations fulfilled,....

TS Ruling: 9/05/2013/ Summary



- LACK OF TRANSPARENCY WAS NOT ALLEGED BY CLAIMANTS; THEY JUST REFERRED TO IMBALANCE
- **NEWLY ISSUED CONCEPT NOT IN THE DIRECTIVE NOR IN THE SPANISH REGULATION: INTERNAL RULE**

CONSIDERS JUST ONE ELEMENT IN THE DEFINITION (IMBALANCE)

APPLIES TO ALL CONSUMERS OF THE DEFENDANTS WHEN USING THESAME CLAUSES (not to third entities).

- EFFECTS FROM 09/05/2013 (Not in petitem. But due to participation of Public Ministry)
- **Already discussed in CJUE**

4.2- Other Lawsuits

Multiple lawsuits have been initiated, and many of them are pending

1

January 2013 Individual
action against BBVA



Petition

Cessation
+
Reimbursement of
paid interest in excess
(retroactivity)

Ruling against Bank

appeal



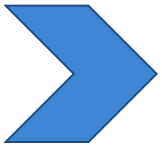
**High Court of Justice 25 March 2015 (and
as of 29/04/2015)**

No retroactivity on the same basis as in 2013
(although the claimants only asked for
cessation in that case)

But effects **since 9/05/2013** (lack of good faith
since then)

2

2010 ADICAE
(Consumers' association)
against 40 entities



Petition

Cessation
+
Reimbursement

Mercantile Court - Madrid 07/04/2016

Ruling against defendants

Clauses unfair are null and void (same basis as
9/05/2013)

Retroactivity since 9/05/2013

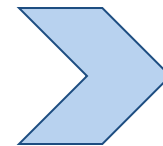
3

Big amount of other
lawsuits.
Pending



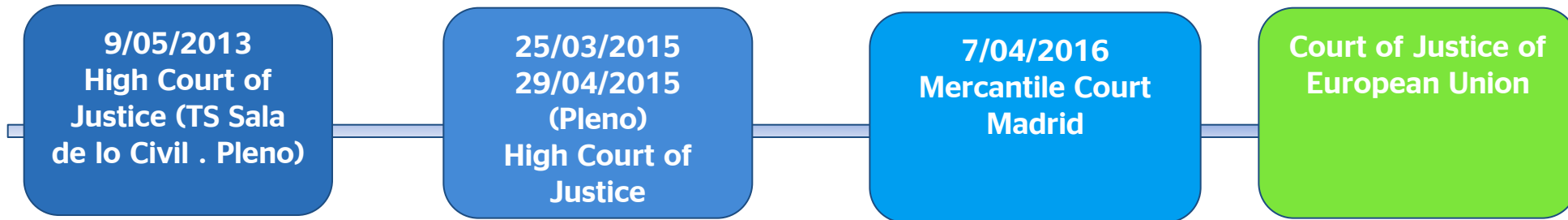
Petition

Cessation
+
Reimbursement



In some cases, question referred to the **CJUE**
for a preliminary ruling (doubts of the Spanish
Courts on whether the jurisprudence of the
High Court as regards irretractivity is in
accordance with 93/13 Directive)

4.3- Main items



- Unfair conditions due to lack of **material transparency**.
- **Irretroactivity** (only in the context of the participation of the Public Ministry. Not raised by claimants)
- Applies to **all consumers of the defendant** Entities, in relation to these clauses
- **Does not extend to other Entities or Clauses**

- Issued as a result of individual actions seeking for cessation and reimbursement
- **Discusses the effect of a resolution in a collective action in relation to further individual actions.**
- All clauses of entities involved in the 09/05/2013 process which are identical to the ones examined in the collective action are null: so individual lawsuits asking for the said clause to be null **lack of procedural object**
- If different clause or entity, no lack of procedural object (not declared null, although criteria already set)
- Retroactivity: **since 09/05/2013** (lack of good faith from that moment)

- Collective action (against 40 Entities)
- Petition: Cessation and Reimbursement
- Ruling:
 - a) Unfair clauses (null and void) : cessation
 - b) Effects from 9/5/2013

- **Court of Justice of European Union**
- Question deferred in the context of some individual lawsuits (**whether retroactivity interpretation of Spanish Courts conforms to Directive 93/13**)
- Will be solved before the end of the year.
- Report from the General Counsel will be delivered in July.

5

Preliminary
CJEU

Ruling

8 questions regarding matters 1 to 3

Preliminary question: whether the requirements of good faith and imbalance are cumulative or not (art. 3 Directive). The Banks acted in good faith



If cumulative, NO unfairness, thus no need to analyze time limits.

1

Extent of the “non binding” principle (Directive 93/13)

- Question not armonized in UE Law
- Art. 6.1. of Directive: “Member States shall lay down that unfair terms used in a contract concluded with a consumer (...) shall, **as provided for under their national law**, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it s capable of continuing in existence without the unfair terms”.

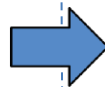
2

Criteria for limiting the effects of the Courts’ rulings in time

Limits to the procedural autonomy of members states are only: a) efectiveness and b) equivalence.
If good faith and public interest are analyzed though, good faith already confirmed and effect around 6000 MM and 37% of the mortgages

3

Right of an effective judicial protection



Also for Banks (very high amount of claims with same demands)

6 Conclusions

5- Conclusions

- The Resolution of the High Court of Justice (TS) dated as of 09/05/2013, goes far beyond what is stated in article 3,1 and 5 of the Directive 93/13
- Accordingly, a **NEW RULE** has been created and has to be considered **internal Law**
- It introduced a new “petitum”, “ex officio” as the plaintiffs did not refer to transparency in their Lawsuit (but to unfairness due to imbalance of rights and obligations). Based on an alleged “jurisdictional duty of transparency control”.
- Irretroactivity: 09/05/2013. Interpretation of effects of the unfairness of the clause raises doubts amongst Courts of Justice: contrary effect to what the jurisprudence of the High Court of Justice are supposed to do (homogeneous decisions)
- Big Legal uncertainty, which should be definitively solved by the CJEU.
- **Entities acted in accordance with the Law and with the very strict transparency rules in force in Spain, as expressly stated and confirmed in all Court Resolutions.**