

FINANCIAL SUPPORT FOR POOR FAMILIES IN ITALY (written by Isabella Ferrari¹)

I. Family struggles in dealing with mortgage repayments

Family finances have assumed an important role in the dynamics of worldwide legislation.

The family has to be considered the primary economic unit, the catalyst for national growth and development; it is a source of earnings as well as of debts, strictly depending on its members' incomes and outgoings. The family's assets, especially amongst poor families, are mainly focused on the family home, often conveyed through the creation of a mortgage.

The consequences of the general breakdown recently suffered by the global economy have produced their effects on European families, incapable of avoiding the constant increase of interest rates.

II. Sub-prime crisis affects the family's assets

Since July 2007 the stock markets all over the world have suffered a huge crisis, caused mainly by the default of the U.S. sub-prime mortgage system².

The most recent studies and publications have made it clear that the current crisis is a sharp consequence of the deregulation policy carried out by the U.S. federal laws in recent years³. In fact, the recrimination is that the lack of strict laws controlling the market may have caused its collapse. One of the most important political voices in favor of the interconnection between deregulation and economic default belongs to the newly appointed U.S.A. President, Barack Obama: on October 6, 2008, Barack Obama largely blamed deregulation for the home bubble ingenerated by sub-primes. He therefore stated that a reform is inescapable.

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² Lewis M., *The End*, in Portfolio.com, December 2008: "In 2000 there had been \$130 billion in subprime mortgage lending, with \$55 billion of that repackaged as mortgage bonds. But in 2005, there was \$625 billion in subprime mortgage loans, \$507 billion of which found its way into mortgage bonds.... The subprime market tapped a tranche of the American public that did not typically have anything to do with Wall Street. Lenders were making loans to people who, based on their credit ratings, were less creditworthy than 71% of the population".

³ Warren E., *Make Credit Safer. The case for regulation*, in Harvard Magazine, Rosenberg Editor, Cambridge, MA, Vol. 110 No. 5, May-June 2008, p. 36-37: "Credit transactions have in fact been regulated by statute or common law since the founding of the Republic. Traditionally states bore the primary responsibility for protecting their citizens from unscrupulous lenders, imposing usury caps and other credit regulations on all companies doing business locally. Although states still play some role, particularly in the regulation of real-estate transactions, their primary tool – interest rate regulation – has been effectively destroyed by federal legislation. Today, any lender that gets a federal bank charter can locate its operations in a state with high usury rates (e.g., South Dakota or Delaware) and then export that states' interest rate caps (or no caps at all) to customers located all over the country. As a result, and with no public debate, interest rates have been effectively deregulated across the country".

According to the American Bankruptcy Institute⁴, U.S. consumer bankruptcy filings increased 40 percent nationwide in October 2008 compared to the same period a year before. The number of foreclosures is strictly dependent on the number of bankruptcy filings; hence it is noticeable that the crisis affects not only business investors but private citizens as well. Indeed, the crisis goes far beyond the families who have their mortgages foreclosed, since the immediate effect of foreclosure is the loss of value in the neighborhood homes. The result is that in a whole neighborhood affected by one or more foreclosures, even families up to date with their mortgage payments can suffer consistent losses as far as the market price of their home is concerned. Eventually, the mortgage debt of each one of the above families turns out to be larger than the value of the home which encompasses the security.

Therefore, the current economic failure negatively affects home ownership and family assets⁵.

III. European mortgage markets

Several remedies have been attempted everywhere in order to avoid the wide-spread breakdown now occurring. Focusing on the EU, the Commission has provided the following remedies.

The “*Consumer Credit Directive*”⁶, which represents the first step in the process of harmonizing credit rules across the Union, and therefore allows consumers to choose the best deal even regardless of national boundaries.

A green paper on “*Mortgage Credit in the EU*”⁷: as a merely consultative paper, it “*sought to enhance cooperation between owners and controllers of registers and facilitate cross-border access to them*”⁸, throughout the creation of the so-called EULIS project (European Land

⁴ Relying on data from the National Bankruptcy Research Center (NBKRC); see 27-3 ABIJ 10, American Bankruptcy Institute, April 2008; <http://www.abiworld.org/>. ABI Executive Director Samuel J. Gerdano stated that “*October's sharp spike in new consumer bankruptcies confirms the severe financial stress on household budgets caused by high debts, flat incomes, and declining home values. We expect the 2008 numbers to be the highest since the new bankruptcy law went into effect in 2005*”.

⁵ The economic crisis has a different impact on families with or without children, according to E. S. Nguyen: in fact, in a recent paper (Nguyen E.S., *Parents in Financial Crisis: Fighting to Keep the Family Home*, in *The American Bankruptcy Law Journal*, Spring 2008, 82 Am. Bankr. L.J. 229), the Author claims that “*parents are significantly more likely than their childless counterparts to keep their home through financial distress*”, due to “*the negative impact of relocation on their children's education*”. Prof. Warren points out the negative consequences of mortgage foreclosures and credit defaults on American families: “*In 2005, the National Opinion Research Council asked families about negative life events: the death of a child and being forced to live on the street or in a shelter topped the list, but filing for bankruptcy ranked close behind, more serious than the death of a close friend or separating from a spouse. Of those who file for bankruptcy, 85 percent struggle to hide the fact from families, friends, or neighbors*” (Warren E., *Make Credit Safer. The case for regulation*, above, p. 35).

⁶ No. 87/102/EC [1987].

⁷ Com. (2005) no. 327 final.

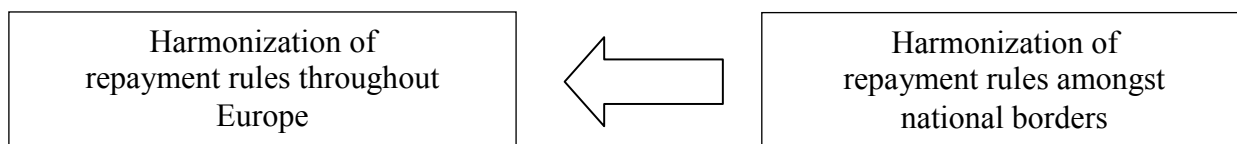
⁸ Com. (2005) no. 327 final, (45).

Information Service⁹) and the Euro-mortgage (“a EU-wide instrument for securing loans on property”¹⁰). The green paper has no binding power, purely launching a wide-ranging consultation intended to figure out the key aspects to be implemented in the process of harmonization¹¹.

The EU Commission has therefore endorsed an unbinding “White Paper on the Integration of EU Mortgage Credit Markets”¹²: although the white paper above gives way to further analysis and consultation, even so it seeks to ease cross-border supply and funding of mortgage credit, increasing product diversity and reducing their costs as a consequence of the higher competitiveness, thus facilitating customer mobility.

The described measures are of great help in sustaining European families’ finances, since they allow credit funding at lower costs. To get the maximum results out of them, and therefore make it possible to engage in cross-border lending, it is necessary to:

- 1) harmonize early repayment rules;
- 2) solve problems concerning distance to customers, missing distribution channels, high processing costs, diversity of languages, different consumer behaviors and finance traditions.



Statistics attest that borrowing is located mainly in a few EU countries¹³: while the Eastern ones have been facing rapid growth since their entry into Europe and therefore have made great use of home loans, the UK has recently registered a sharp standstill following its market slow down. Germany takes little advantage of mortgages, since the average rate of German home ownership is the lowest in Europe, rounding out to 41% according to Eurostat data¹⁴. Greece, Spain and Italy on the other hand have been facing a continuous growth in the past ten years both in building construction and the mortgage market. The said growth has just arrested as a consequence of the global economic crisis.

The records above allow interesting reflections.

⁹ A consortium of European national land registers, that makes it possible to search title on-line through a single Internet based portal. See www.eulis.org.

¹⁰ Com. (2005) no. 327 final, (47).

¹¹ After the publication of the green paper, the EU Commission has appointed a research team (so called London Economics) and a special group (Mortgage Credit Forum Group) to study the costs and benefits of further integration of the EU mortgage credit market.

¹² Com(2007) 807 final.

¹³ The so-called “pan-European mortgage market”, as the EU Commission defines it in its report (London Economics, Report for European Commission, DGInternal Market and Services, August 2005, p. 8.

¹⁴ www.eurostat.com

Taking into consideration the fact that the ranking of populations making use of mortgages in most cases comprises borrowers between the age of 25 and 54¹⁵, it is of immediate evidence that mortgages arise mainly in newly formed families (married, cohabitating or same sex partnerships), purchasing approximately around the standard age for settling down. Hence money lenders should try to develop economic instruments affordable especially to young people, who are at the starting point of their professional career. They should also consider the fact that young people are used to crossing domestic boundaries, physically as well as on-line, in order to search for the best deal: young generations speak several languages, handle modern technology easily and have an in-depth knowledge of the business economy. Therefore nowadays customers are much more demanding than they used to be, and consequently they force the market to develop to meet their requirements.

Three elements are involved in mortgage lending: the borrower, the money lender and the property. In order to establish a cross-border financial service, at least one of the three elements above has to take place in a foreign country. The result is to call upon a new set of rules, able to protect customers on the international market. The European legislator's ultimate aim is to assure uniform rules everywhere in order to avoid lenders' forum shopping, that is to say to avoid the transfer of the credit institutions' registered office from one country to another as a consequence of the more advantageous treatment available elsewhere. Still it has to be pointed out that money lenders are permitted to move across Europe: there is no legal prohibition whatsoever; the only restraint being to ensure compliance with national as well as European regulations.

On the other hand, uniform rules allow customers to look for and to choose financial instruments on an international basis, which is surely broader and more competitive.

The need for a European policy on mortgage credit has just emerged, due to the consideration that a single marketplace would permit cheaper and better loans for all Europeans and would stimulate a genuine EU trade for home loans transcending national boundaries.

Families are therefore directly and immediately affected by such open financial bargaining, characterized by more transparent and safer deals. As a consequence, European families are concerned by the regulations governing the market, consumer protection laws included.



In protecting the consumer, information plays a central role: to make legal consumerism work properly it is in fact necessary that all customers are aware of the tools at their disposal. They must know which actions they are able and unable to take.

¹⁵ Sparkes P., *European Land Law*, Hart Publishing, Oxford and Portland, Oregon 2007, p. 381.

The information therefore has an impact on the operation of consumer protection. “*In order to enable consumers to make their decisions in full knowledge of the facts, they should receive adequate information...prior to the conclusion of the credit agreement, on the conditions and cost of the credit and on their obligations...such information should include the annual percentage rate of charge applicable to the credit, determined in the same way throughout the Community*”¹⁶.

Having regard to the protection against unfair or misleading practices and to the creation of an area where the free movement of goods required by the EU Treaty is fully permitted, the European Parliament, jointly with the Council of the EU, has adopted the *2008 Directive On Credit Agreements For Consumers* (2008/48/EC). In light of the said directive, all the member States are obliged to implement its rules within their domestic legal systems in two years time.

Nevertheless the directive above does not provide sufficient protection to consumers, as according to art. 2 it shall not apply to credit agreements secured by a mortgage¹⁷. It means that the green paper and the white paper mentioned before shall generate yet another provision, apart from the 2008/48/EC directive: they shall end up with a directive precisely designed for mortgage lending.

There is in fact no reason for excluding such a relevant part of financial credit from legal regulation. Indeed, the current financial crisis has a lot to do with the effects of de-regulation of the mortgage system in the U.S.A. Therefore it is strictly necessary to prevent similar results in Europe, through a strict regulation of the market.

Hence, the common worry for EU families is to find a concrete and uniform protection for home loans. It is also necessary to provide them with standard and comparable notice on advertising, pre-contractual information, annual percentage rate of charge and contractual information. Is there a way to accomplish the above goals?

Pending European action, the mortgage industry continues to be regulated by a voluntary code of conduct¹⁸. The code, that came into effect on September 30, 2002 and has already been signed by more than 3,600 lending institutions, establishes the following information to be provided to consumers across the EU prior to signing a loan contract: “*general information about home loans on offer and personalised information at a pre-contractual stage to be presented in a “European Standardised Information Sheet”*”.

Then uniformation of law implies the diffusion of as much information as possible.

¹⁶ Directive 2008/48/EC of the European Parliament and both the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, (19). Articles 4 to 9 deal expressly with “information and practices preliminary to the conclusion of the credit agreement”, therefore posing rules intended for harmonizing the credit market on the European level.

¹⁷ The directive applies only to loans whose value is comprised between 200 and 75.000 euros.

¹⁸ So called “*European Agreement on a Voluntary Code of Conduct on Pre-Contractual Information For Home Loans*”; available at http://ec.europa.eu/internal_market/finservices-retail/home-loans/code_en.htm.

However, information involves costs and expenses. Hence information affects the cost of credit: as more information means greater knowledge on the consumers' side, ensuring consumer's knowledge is a primary necessity for a financial system to operate well. The more acquainted the borrower is with credit information, the better the system works out¹⁹.

IV. Solutions coming from Italy

It is clearly noticeable that before removing barriers through the European borders, in order to set up a genuine EU common credit market (and therefore help families dealing with home loans), it is of immediate urgency to remove the national ones still in existence. This is the reason why so many different acts have come into force in recent times, including in Italy.

The recent laws no. 40/2007 and no. 93/2008 have put in place a fundamental set of rules, expressly intended to ensure consumer confidence and to allow freedom of credit movement inside the domestic market.

1. The Bersani law

The law no. 40/2007²⁰, or the so-called "*Bersani*" law, after the name of the minister who sponsored it, has allowed the mortgage transfer, during its term, free of any charge, from its original mortgagee to a different one on better conditions.

Even before the fulfillment of an actual European market, the foretold law permits the mortgage transfer within Italian borders, and therefore sets the stage for the credit shift on European bases.

According to the *Bersani* law, in order to give way to the mortgage transfer it is necessary for the mortgagor to obtain the exact quantification of his/her remaining debt. He/she has to ask for its calculation to his/her mortgage lender (which is required to respond within ten days).

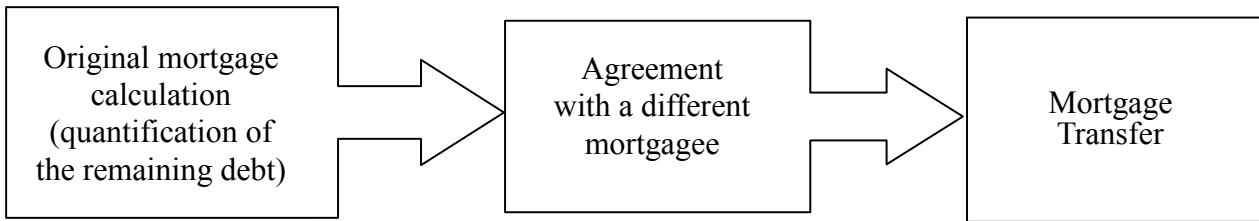
Then a new mortgage loan is negotiated and eventually signed by the parties (the mortgagor and the mortgagee taking over the previous loan): the new agreement has to be signed in the presence of a public notary²¹ (it is not necessary that the agreement takes the form of an official document, being sufficient for its signatures to be officially authenticated). On the same

¹⁹ It must be said that whereas there are certain organizations promoting the code (such as the Spanish Asociación de Profesionales Asesores Independientes Financieros), some others are definitely against it (see the European Association of Public Banks, that opposes regulation on the grounds that it could disrupt well-established efficient practices and increase mortgage costs).

²⁰ First introduced in the form of a law decree, no. 7/2007, then converted into law on April, 2nd 2007; published on Gazzetta Ufficiale n. 77, dated April 2, 2007.

²¹ "A notary public is defined as a public, civil, or ministerial officer, and an impartial agent of the state, who in the performance of his duties, exercises a delegation of the state's sovereign power, as in attesting the genuineness of any deeds or writings in order to render them available as evidence of the facts therein contained, and in administering oaths and attesting to the authenticity of signatures. The notary is an officer known to the law of nations; hence his official acts receive credence, not only in his country, but in all others in which they are used as instruments of evidence" (58 Am. Jur. 2d 523).

day, the original mortgagee is paid by the one taking over the debt (which therefore gets a receipt of payment) and the change of the mortgagee's name is annotated on the land registry²².



(Transfer of mortgage according to the so-called "Bersani law")

Some aspects concerning the described operating procedure require specific comment.

First of all, the new mortgage expires on the same day the previous one was supposed to end. This means that the parties do not sign and generate a new autonomous mortgage, intended to last twenty years²³ from its signature: in fact, the transferred mortgage is a surrogated loan, which takes over the rights and burdens of its source.

Another significant facet concerns costs: the notary's authentication is charged to the mortgagor, while the annotation on the land registry is free from any fee.

Any financial aid already enjoyed as an incentive for the purchase of the family home²⁴ is saved, since the mortgagor still benefits from the same tax treatment he/she had before the transfer was pursued if the value of the transferred mortgage does not exceed the residual debt of the original mortgage.

Furthermore, the parties are free to modify all the terms of the mortgage, except for names and values. Neither the consent of the primal mortgagee (he de facto undergoes the transfer) nor the consent of any other personal guarantor involved is legally required: the transfer is successfully completed when the second mortgagee pays the first mortgagee and the relative notice is given on the land registry.

The *Bersani* law introduces one more significant change, whose effects greatly impact upon private families: the abolition of fines when mortgages are paid off early, under the specific circumstance of a home loan for the purchase or for the restructuring of a building used as a family home or as a business office by a freelancer.

²² Pursuant to Article 2843 Italian Civil Code, which states that the mortgage transfer is effective from the moment it is annotated on the land registry by the Registrar. The subsequent possible discharge of the mortgage requires the mortgagor's and mortgagee's consent.

²³ According to the Italian law, the maximum length for a mortgage is twenty years; then it has to be renewed (the renewal maintains all the related priorities).

²⁴ Laws no. 168/1982, 118/1985, 75/1993, 243/1993, 549/1995; see http://www.agenziaentrate.gov.it/ilwcm/resources/file/eb82000abab4d01/compravendita_casa_2007.pdf. If the purchase involves the family home and is therefore taken over by private individuals (not by a company), the contract's registry fee is reduced from 7 to 3% of the total purchase value and the mortgage and cadastral registry fees are charged 168 euro each instead of 2% (for mortgage registry) and 1% (for cadastral registry) of the total purchase value.

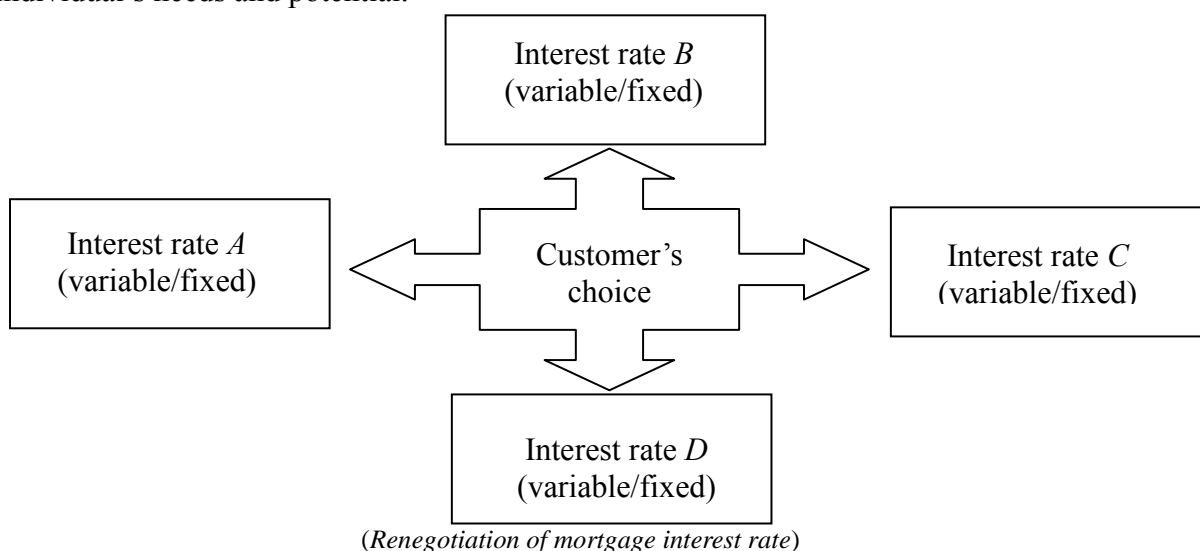
To value the scope of such an alteration, it has to be said that up until February 2, 2007 the parties used to agree the percentage rate due by the borrower in case of early repayment in the mortgage contract: it was a rate generally comprising between 1% and 2% of the residual debt. Since the *Bersani* law has come into force, no more fees are due for early repayments of home loans. The goal is to assist private family assets: indeed, the abolition of early repayment fees applies exclusively to family homes, since the foresaid fees are still due in case of mortgages granted for construction purposes²⁵, in the case of leasing, open-ended credit lines and any other financial investments taken on. The reason for the different legal treatment reserved to the family home in comparison to all other buildings resides once more in consumer protection policy.

2. The renegotiation

Since the promulgation of the law decree no. 93/2008 (dated May, 27th 2008, and converted into law no. 126/2008 on July, 24th 2008), another important aspect has to be taken into consideration in relation to mortgages: the so called “*renegotiation*” or “*renegotiation Tremonti*” (after the newly appointed Finance Minister, who has sponsored it).

First of all, it has to be pointed out that the above law is entitled “*Urgent Rules To Save The Purchasing Power Of Families*”. As it appears from its title, the new law is especially designed as an aid to medium-low income families; in fact its provisions regard mortgages (which are usually taken over by people who cannot afford to pay the entire purchase price), abolition of ICI tax for the family's main home (see next paragraph) with the express exclusion of luxury homes, and renegotiation.

Renegotiation involves comparisons between different mortgages’ contracts and different mortgages’ rates available on the market, and the choice of the best ones related to each individual’s needs and potential.



²⁵ Fausti P.L., *Anticipata Estinzione del Mutuo e Portabilita' dell'Ipoteca (Articoli 7, 8 e 8-Bis della Legge 2. 40)*, in Banca Borsa Titoli Di Credito Rivista Bimestrale di Dottrina e Giurisprudenza, Vol. LX-Suppl. al n. 5/07, Giuffre' Editore, Varese 2007, p. 3 e ss..

As the graph above shows, renegotiation has mainly to do with interest rates.

A variety of mortgage instruments are now in use, including fixed and variable rate. The novelty of the 2008 law decree is to set the interest rates on the nominal values in force in the year 2006²⁶, so that the negative difference will be paid through a separate mortgage, created collaterally to the main mortgage²⁷.

The collateral mortgage has to be repaid once the main one has been fully extinguished, through payments in installments of the same amount as the ones due in the course of the main mortgage.

The fundamental key points of the described reform are the substantial lack of any formality or expense on the customer's side.

Indeed, due to the agreement recently achieved and formalized by ABI (Italian Bank Society) together with the Italian Finance Ministry²⁸, rules for renegotiation have been officially posed²⁹. Mortgage institutions had the possibility to elect to enter into the above convention agreed by ABI. All Italian banks have decided to join the convention, and have therefore given appropriate information to their customers³⁰. Hence, all Italian lenders are obliged to apply the interest rates in force in the year 2006 to everyone, even to customers in arrears.

Once the mortgage has been rescheduled, the reduced payments should start no later than three months after the conveyancing of the renegotiated mortgage.

The *Tremonti* reform provides the possibility for the mortgagor to discharge the renegotiated mortgage free from any fee or time limit³¹. Besides, customers can negotiate privately with their own mortgage institutions and ask for different conditions, which must be even better than the ones agreed by ABI.

What is the overall impact of law no. 126/2008 on families, and in particular on poor families?

A proper reply to the addressed question must distinguish between poor customers and customers almost in arrears.

²⁶ Arithmetic mean.

²⁷ The interest rate to be applied to the collateral mortgage is calculated in relation to IRS (interest rate swap) in ten years time since the day the renegotiation was signed, increased by 0,50.

²⁸ Signed in Rome on June 18th, 2008 by Prof. Vittorio Grilli (on behalf of the Finance Ministry) and by Dc. Giuseppe Zadra (on behalf of ABI).

²⁹ The foresaid rules apply to mortgages dated before May, 28th 2008.

³⁰ Before the prescribed date, August, 29th 2008.

³¹ It is forbidden by the law and by the ABI convention (art. 6(3)) to ask the mortgagors for taxes, payments or any kind of contributions.

In fact, even though the monthly payments due from the process of renegotiation are lower, the renegotiation increases the entire length of the mortgage: that is to say that the mortgagor will end up paying less for a longer time period.

Therefore, the renegotiation is disadvantageous in the long term. However, it is for sure a good compromise for a debtor nearly in arrears, since the renegotiation trims down the monthly installments.

In conclusion, the effects of renegotiation on the total family assets vary from case to case: a single family could enjoy a great benefit because of the renegotiation, since more money could be available for its needs; or rather it could be the case that the most important concern for a family is to cut down its debts as soon as possible and therefore it would opt for avoiding renegotiation.

Yet another significant aspect must be underlined: Italian mortgages usually last over twenty years (being amongst the longest in Europe). Because of renegotiation, the family mortgage will be extended by at least one more year. That is to say that in the end, general family planning will not undergo a huge variation.

3. The abolition of ICI

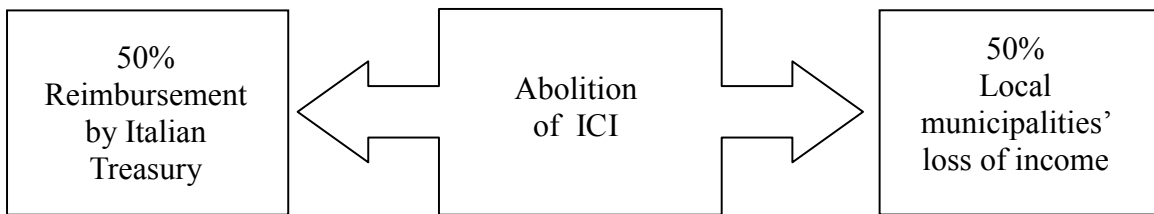
The law decree no. 93/2008 (art. 1) has introduced yet another important change in favour of family assets: the abolition of the municipal tax on immovable property (so called “ICI³²”) for the family's main home.

The ICI tax had to be paid every year; its value was fixed in relation to the cadastral value of the property, increased by the municipal aliquot. Hence the above removal generates significant consequences as far as local municipalities are concerned: indeed, forecasts evaluate the total loss on the municipalities' side to be around one billion euros (668 million for the year 2008 and 301 million for the year 2009), as more than 23 million houses will benefit because of the reform.

The burden of such a consistent financial manoeuvre cannot be met exclusively by municipalities, being too onerous for them; the total loss will therefore be split between the national Treasury and the local municipalities.

In fact the national government will immediately reimburse the municipalities for half of their total loss. Criteria and operative rules are still under construction, but again the result in favour of single consumers is certain, as from June 2008, they are no longer required to pay the foresaid tax.

³² ICI is an acronym for “*imposta comunale immobili*”.



(Abolition of the tax on immovable property for the the family main home)

The analysed reform is likely to generate two sets of problems: on one hand, there is the economic issue, concerning the concrete chances that the national Treasury and local municipalities can afford the abolition of ICI; on the other hand, there are problems connected with the social effects arising after the law's introduction. In fact, the abolition of ICI has already produced (within just six months of the law entering into force) a huge increase in the number of legal as well as *de facto* separations. This has to do with the consideration that separated spouses gain the right to have two separate family homes, which can both benefit from the abolition of the tax on immovable property.

Therefore many families are now pretending to be separated, just in order to make the vacation home acquire the status of family home, and by doing so saving on tax payable.

V. Conclusion

The above measures have just come into force. A comprehensive evaluation of their effective reach will be possible in future years.

Yet, it is already certain that there will be many consistent advantages for consumers, the final question being mainly whether the national budget and mortgage institutions will be able to bear the described reforms.

It is in fact probable that the possibility of renegotiating mortgages will give way to a trend in decreasing rates, since every mortgagee will try to offer better conditions than others in order to catch more customers. Every single mortgage institution will move towards the maximum efficiency possible, that is to say will try to reach its own customers' objectives at the lowest possible cost. Better conditions means reducing the monthly interest rates as much as possible, consequently placing the burden of high risk of a huge and long-lasting difference between the up-dated interest rate and the negotiated one.

On the other hand, it has to be demonstrated whether the national Treasury and local municipalities will be capable of bearing the costs of the abolition of ICI, which has always been a very remunerative tax.

And last but not least, the reforms above will have to harmonize with the EU market.

These are economic and political questions: only time can say whether good results

will finally prevail.