On 21 February 2019, the Congress of Deputies approved the Law regulating real estate credit agreements (the Law), which is due to be published in the *Boletín Oficial del Estado* (Official State Gazette) in the next few days and to come into force three months thereafter. The Law, which will then apply to new mortgage agreements and, in certain specific cases, to outstanding agreements, transposes Directive 2014/17/EU[1] into Spanish law. This directive regulates customer protection, transparency and conduct in relation to credit agreements for the acquisition of residential real estate. The Law also contains other provisions not specifically envisaged in the directive, which further strengthen borrower protection in certain areas. This box summarises the main features of this law and analyses its possible effects on the mortgage market.

The Law introduces highly detailed rules for the pre-contractual stage, requiring lenders to provide borrowers with information on the content of agreements through the European Standardised Information Sheet, which will be considered to be a binding offer, and a standardised warning sheet including information on the most important clauses and features of the agreement. At the same time, notaries are assigned a more important role, being required to ensure that customers have been provided with all the necessary information within the periods laid down and to provide advice on the content of the agreement. The content of the notarised deed will be considered evidence of such advice and of the borrower's understanding and acceptance of the content of the documents delivered, for the purposes of substantive compliance with the principle of transparency. The property registrar, meanwhile, will refuse to register those clauses of agreements that are contrary to legal provisions or that have been declared null and void by the Supreme Court.

Also, a number of rules are introduced on the conduct and internal organisation of lending institutions, requiring the solvency of the borrower to be assessed before and during the life of the loan, the remuneration of the lender's staff not to be linked to the volume of credit transactions (to avoid adverse incentives) and a general ban on tying practices. Moreover, unlike at present, when most of the expenses related to the loan agreement tend to be borne by the borrower, after the entry into force of the Law, the agency, notary and registration fees will be payable by the lender, the borrower bearing only the appraisal fees and the cost of any copies requested of notarised documents.[2]

The regulations currently in force limit only the maximum fees for early repayment (i.e. when the customer repays all or part of the outstanding debt early) in the case of variable rate agreements. As seen in Table 1, the Law reduces these maximum fees from 0.5% or 0.25% of the repaid principal, according to whether the repayment takes place during the first five years of the loan or thereafter, to 0.25% during the first three years (or alternatively 0.15% during the first five years, depending on what the parties

1 Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010.

2 Stamp tax is also payable by the lender, following the entry into force of Royal Decree Law 17/2018.

Table 1

	Life of the loan (years)	Current regulations (%)	New law (a) (%)	
Maximum fees for:				
Change from variable to fixed rate	0-3	0.50	0.15	
	3-5	0.50	0.00	
	Over 5	0.25	0.00	
Early repayment on fixed interest rate loans	0-10	(b)	2.00	
	Over 10	(b)	1.50	
			3 years (c) (%)	5 years (c) (%)
Early repayment on variable interest rate loans	0-3	0.50	0.25	0.15
	3-5	0.50	0.00	0.15
	Over 5	0.25	0.00	0.00

SOURCE: Law regulating real estate credit agreements.

a Fees may not exceed the financial loss caused to the lender.
b The fees applied shall be those agreed by the two parties. In the absence of an agreement, the fees shall be the amount of the financial loss to the lender.
c Term agreed for charging of fees.

agreed) and 0% thereafter. The Law also introduces maximum limits for early repayment fees in the case of fixed rate loans (2% of the repaid principal during the first 10 years of the loan, and 1.5% thereafter).[3] The higher fees in the case of fixed rate loans are justified by the financial loss lenders may incur in the event of early repayment. This loss arises when the market interest rate falls below the mortgage rate, since the interest that the lender would have received during the residual life of the loan will be greater than the market return available on similar assets when the repaid funds are reinvested. As seen in Chart 1, this loss basically depends on the residual maturity of the mortgage, the (positive) differential between the mortgage rate and the market interest rate and, albeit to a lesser extent, the level of market returns.[4] This chart also shows that the maximum limits established by the new regulations (the dotted lines) would in some cases not fully cover

3 In any event, the amount of fees may not exceed, either in the case of fixed rate loans or in that of variable rate loans, the financial loss caused to the lender.

4 Chart 1 shows the present value of future losses for the institution, obtained using a discount factor that depends on the market interest rate. The higher the market interest rate the more future losses are discounted and thus the lower their present value.

Chart 1
LOSS FOR THE LENDER ASSOCIATED WITH EARLY REPAYMENT UNDER FIXED RATE LOANS ACCORDING TO THE DIFFERENCE BETWEEEN THE MORTGAGE RATE AND THE MARKET RATE, THE MARKET RETURN AND MATURITY

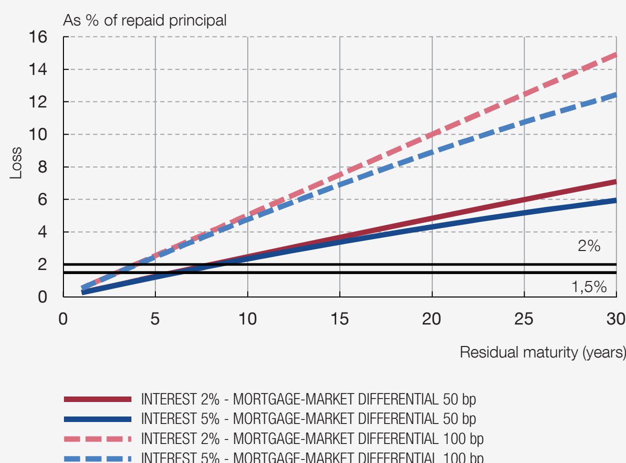


Chart 2
NUMBER OF PAST-DUE MONTHLY INSTALMENTS TO REACH THE 3% LIMIT ACCORDING TO THE INTEREST RATE APPLIED, RESIDUAL MATURITY AND PROPORTION OF LOAN REPAID

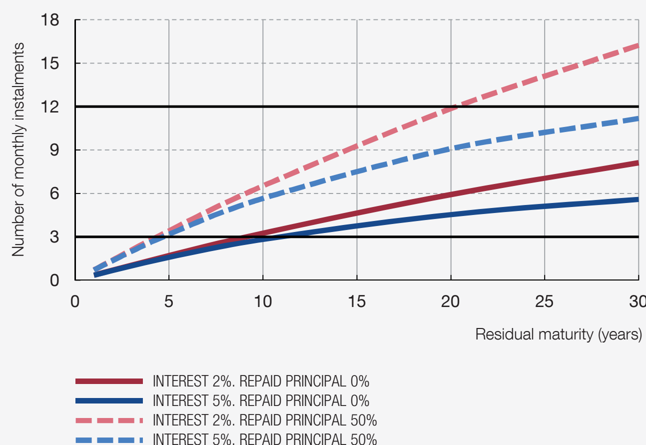


Chart 3
NUMBER OF PAST-DUE MONTHLY INSTALMENTS TO REACH THE 7% LIMIT ACCORDING TO THE INTEREST RATE APPLIED, RESIDUAL MATURITY AND PROPORTION OF LOAN REPAID

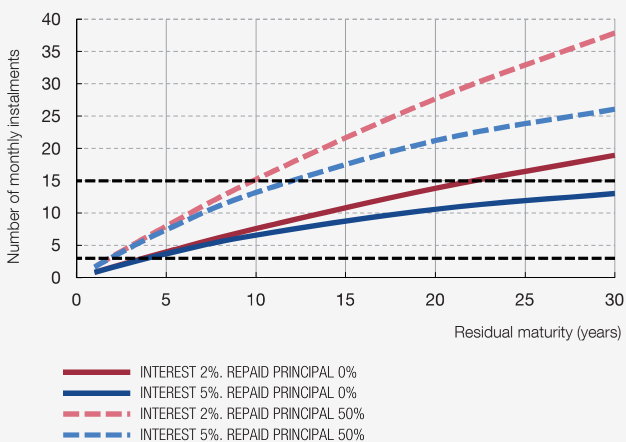
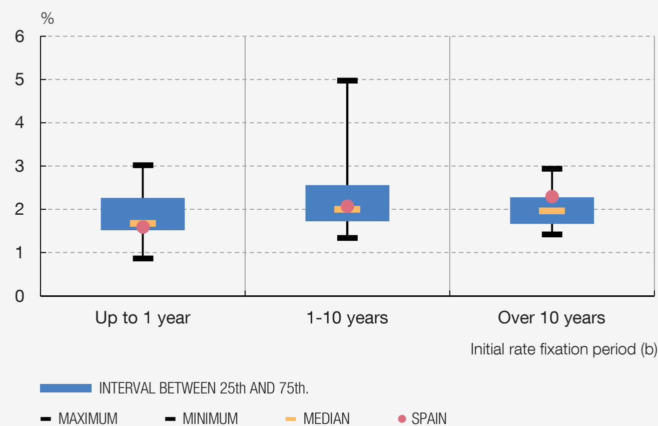


Chart 4
DISPERSION OF MORTGAGE RATES IN THE EURO AREA (a)



SOURCES: ECB and Banco de España.

a Average rates on new lending in December 2018 for each country.
b Period for which the fixed rate at origination is maintained.

the financial loss suffered by the lender in the case of fixed rate loans.

The Law also regulates acceleration, namely the right of the lender to terminate the agreement in the event that the borrower has failed to pay a certain number of loan instalments, as a prior step to realising the collateral. Specifically, it establishes that in order for the lender to be able to exercise this right during the first half of the life of the loan the unpaid instalments must exceed 3% of the loan principal or 12 monthly instalments or, during the second half of the loan, 7% of principal or 15 instalments. Further, the lender must have requested the borrower to pay the outstanding amount, while granting the latter a period of at least one month in which to do so. These provisions will not only apply to new agreements but also to existing mortgages with acceleration clauses, unless the debtor alleges that the clause is more favourable to it or that the right to terminate arose before the entry into force of the Law. As seen in Chart 2 (for the first half of the life of the loan) and Chart 3 (for the second half), the number of unpaid instalments necessary to reach 3% or 7%, respectively, of the loan principal, which gives the lender the right to terminate, depends on the interest rate, the residual maturity of the mortgage and the amount of the loan already repaid. In most cases, this number of monthly instalments is clearly more than three (the dotted line in the charts), the number usually specified in mortgage clauses as the requirement for acceleration.[5] As a result, the Law will generally lengthen the time taken to recover past-due amounts in the case of non-performing loans.

Lastly, the law introduces incentives for the subrogation (change of institution) and novation (change in the terms and conditions of the mortgage with the same institution) of loans when a variable rate mortgage is converted into a fixed rate one (see Table 1). Specifically, maximum fees are established that are lower than those generally charged for early repayment of variable rate loans: 0.15%, during the first three years (as opposed to 0.25% when the fees are set for a period of three years) and 0%, subsequently (as opposed to 0.15% between the third and fifth years when the fees are set for a period of five years). These limits are also lower than those currently in force (0.5% during the first five years and 0.25% thereafter). These reforms will apply to both new and existing loans.

The approval and forthcoming entry into force of the new Law may have various effects on the mortgage market. First, the introduction of binding clauses (as in the case of acceleration and early repayment), along with the increase in information available to customers during the pre-contractual stage, can be expected to contribute to reducing legal uncertainty and the currently high level of litigiousness in this market, which should lead to more lending and an improvement in the functioning of the mortgage segment.

Moreover, the greater transparency and standardisation of the information available on agreements and the lowered transaction costs associated with a change in lender may raise the competition from both domestic and European operators. As regards the latter, it should be noted that one of the objectives of the directive was to increase the integration of European mortgage markets. In any event, given that notable cross-country differences still persist between the law applicable in this area and, moreover, as seen in Chart 4, Spain is not among the countries with the highest levels of interest rates in most segments,[6] the effects on the cost of borrowing associated with greater integration of these markets at the European level can be expected to be moderate.

At the same time, the increase in the mortgage costs borne by lenders and, in particular, the maximum limits on early repayment fees in the case of fixed rate agreements may lead to a certain increase in the rates charged on new loans, especially in the case of those applied to the latter type of agreement.

The delay in the recovery of past-due debt for lenders may result in a certain tightening of lending conditions, especially those for debtors with a higher risk profile. Also, the stricter borrower solvency assessment requirements may exacerbate these latter effects, while being conducive to an improvement in the quality of institutions' loan portfolios. In any case, the final impact of the Law on mortgage financing conditions will also depend on the effects in the opposite direction associated with the possible increase in competition and the reduction in legal uncertainty.

Finally, the greater ease with which variable rate loans can be converted into fixed rate ones may encourage a shift in the stock of debt towards fixed rate agreements, reducing the high current weight of variable rate mortgages.[7] This would lead to a transfer of interest rate risk from debtors to creditors, who are in principle in a better position to manage such risk. However, the extent of this effect will depend on debtors' risk/cost preferences, i.e. the extent to which, in order to secure a fixed rate of interest over the life of the loan, they are prepared to incur a higher expected cost, reflecting an interest-rate risk premium and a premium associated with the possibility of early repayment.

5 Current legislation does not regulate acceleration, but most outstanding agreements include acceleration clauses that generally give the lender the right to terminate when three instalments remain unpaid.

6 As at the reference date of the chart, the percentages of the amount of new transactions in Spain by maturity were: 35% up to one year, 32% between one and 10 years and 33% over 10 years.

7 Fixed rate transactions account for only around 10% of the total stock of loans, although in recent years there has been an increase in this type of loan in new lending.