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# Overview of European consumer credit law

Protection of consumers with  
foreign currency mortgages in the  
aftermath of the Icelandic crisis

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HÁSKÓLI ÍSLANDS

# Overview of European consumer credit law:

## Protection of consumers with foreign currency mortgages in the aftermath of the Icelandic crisis

M. Elvira Méndez-Pinedo \*

### 1. Introduction

The impact of the recent financial crisis in Iceland has brought into light the need for a better protection of consumer's economic and legal interests in the field of financial services, house mortgages and unfair contractual terms. Price indexation clauses are specially regulated in European law which establishes strict conditions for their legality. Most usual clauses offered to consumers by the banks and financial institutions operating in the the Icelandic financial services market were clauses linking the principal amount to the price inflation index (*verðtrygð lán*) or linking the payments of both principal and montly installments to foreign currencies (*gengistrygð lán*).<sup>1</sup> Both fall under the Icelandic law on interest and price indexation (*Lög um vexti og verðtryggingu nr. 38/2001*). This article will focus mainly on Icelandic house mortgages denominated in krónas but linked to foreign currencies –price indexed- contracted by consumers in the period 2004-2008.

Icelandic law allowed mortgages denominated in foreign currencies but prohibited mortgages in Icelandic krónas (ISK) linked to the fluctuation of foreign currencies.<sup>2</sup> After the financial crisis in October 2008 and the collapse of the ISK króna, consumers with this kind of contracts have seen their debt doubled. Many consumers have taken cases before the courts presenting their deep concerns about the total/partial nullity of the mortgage contracts signed in light of the Act nr. 38/2001. The national judges have been asked to review the legality of some contracts and to decide for the consequences of illegality if necessary. Presently there are many cases waiting to be adjudicated at local level (district courts). The Supreme Court ruled on the 16<sup>th</sup> June 2010 that car loans contracted in ISK and linked to foreign currencies were illegal as there was never exchange of foreign currency between lender and

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\* The author is Professor of European Law at the University of Iceland. The author would like to disclose a personal interest on the subject of foreign currency mortgages as she contracted a “gengistryggt lán” (loan in ISK linked to foreign currencies) with one financial institution in Iceland. At the time of writing, a case was adjudicated by the District Court of Reykjavík on 28.9.2010 which ruled under Act no. 38/2001 that the principal amount was due in ISK with the general interest of the Central Bank (effects ex tunc). An appeal is pending before the Supreme Court

<sup>1</sup> Mortgages can be denominated in a foreign currency (foreign currency loans or *erlend lán*) or denominated in a national currency but indexed to a foreign currency (*gengistrygð*). In this study we refer mostly to the *gengistrygð lán*. Mortgages can also be contracted with foreign institutions as opposed to domestic institutions although this was never the case in Iceland.

<sup>2</sup> All banks and financial institutions offered nevertheless these loans to the consumers and the banks specially advertised them by focusing on their lower interest rates. Risks associated to the devaluation of the national currency were minimised if not set aside or simply ignored by lenders and borrowers. In general, consumers were not duly informed of risk as pre-contractual information on this point was not given. No code of conduct regarding responsible borrowing and lending existed either. Consumers of course did not know that Icelandic law prohibited other price-indexing clauses different than *verðtrygging*. The main reasons why consumers turned to these loans were the lower interest rates and to avoid the automatic price indexation clauses that Icelandic loans carry.

borrower (cases no. 92/2010 and 153/2010). In another ruling of 16th September 2010 in the case nr. 471/2010 the Supreme Court decided that the Central Bank's non-indexed interest rates were to replace foreign currency indexation and the interest rates that were originally agreed upon in the case of car loans. The Supreme Court confirmed the ruling of a lower court and provided a solution more beneficial for the consumer at that case. At the time of writing a essential question still remains pending: the scope and terms of this jurisprudence on car loans for house loans. Put it another way, the legal effects of the Supreme Courts's ruling on car loans for similar foreign currency indexed house loans and the consequences of the partial nullity of the contracts regarding the payment of principal and interest rates.

The main research questions that this paper will tackle are the following ones: Do consumers in Iceland who signed this kind of house credit mortgages enjoy protection in European law? What are the obligations concerning the application and interpretation of (European) consumer law for the Icelandic judges?

Civil law, real property law and procedural law in general belong to the realm of EU Member State laws, but – even without pleading for an Europeanization of this field- it is useful to look at at some contract problems in the context of European consumer law – both in the interest of national law and European private law. For this reason, the final aim of this contribution is to describe the status quo of the European consumer credit law concerning the protection of consumers in the field of house mortgages and assess the legality of price indexation clauses such as foreign currency indexes as well as its relevance for the protection of Icelandic consumers with home mortgages linked to foreign currencies. Further research will have to be done regarding other kind of price indexation clauses currently used for home loans (*verðtrygging*) in Iceland under the light of European consumer law. This topic is left outside the scope of this research.<sup>3</sup>

This study is divided into two parts where we explore 1) the European Union consumer law *acquis* and strategy as well as the current policy on mortgage credit law and 2) the relevance of European consumer credit law in the EEA legal order and in Iceland. While studying concepts such as unfair contractual clauses and practices and other general principles of consumer law applicable in general, we will discover how the EU is in search for a modern, clear and un-fragmented policy/European Consumer Code protecting consumer's economic and legal interests in these circumstances. Last but not least, reference is done to the relevance of this EU *acquis* to the EEA legal order and the protection of consumers in the Icelandic cases pending before the courts. For constraints of space, this study does not cover European contractual law although readers are advised to refer to the Principles of European Contract Law upon which a Common Frame of Reference for future harmonisation has been drafted (which might be the basis for a future European Civil Code) as general contract law is also applicable to consumer problems in the absence of specific legislation adopted.<sup>4</sup>

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<sup>3</sup> The standard price indexation clause used in Iceland for home mortgages (*verðtrygging*) allowed by Act Nr. 38/2001 might fall for the time being outside the direct scope of Consumer Credit Directive 2008/48/EC incorporated to the EEA legal but is highly questionable in the light of general principles of European consumer law. Reasons for questioning this practice under EU law: 1) for consumer credit other than home mortgages, consumers must know in advance the annual percentage rate of charge (the total cost of the credit to the consumer, expressed as an annual percentage of the total amount of credit); 2) price indexation clauses must be individually negotiated and not prejudicial to consumers in order to be lawful and 3) financial risks associated to such price indexation clauses cannot be properly assessed by an average consumer in advance (economic history of real inflation in Iceland proves irrelevance of Central Bank's predictions and failure of inflation-control policy).

<sup>4</sup> On the status and development of European contract law (Principles of European Contract Law, Draft of a Common Frame of Reference and Project of a European Civil Code) see for further reference: Beale, H., "European Contract Law: the Common Frame of Reference and Beyond", in

Methodology chosen for this task is standard in the field of European law. Legal method relies in a combination of study of principles provided by legislation (as in civil law) and case-law (as in common law) and is comparative in approach with a European perspective. The scope is determined mostly by European legislation and case-law from the Court of Justice of the European Union (ECJ). Both “hard law” (proper EU legislative measures) and “soft law” (recommendations and/or policy initiatives) (such as the EU Consumer Compendium or EU Recommendations) are taken into account. The approach will show how the complex problem of consumer protection in the field of house mortgage credits requires a combination of different legal techniques and fields and the coordination of a plurality of lawmaking levels and judicial actors in order to be effective. The study is mostly descriptive but incorporates some empirical data (ie: judgments from the ECJ).

## 2. European consumer law *acquis* and strategy: In search of a modern, clear and un-fragmented policy/European Consumer Code protecting consumers economic and legal interests.

As the European Commission describes, the *acquis communautaire*<sup>5</sup> on consumer protection is limited to certain issues where EU law has proved essential for the internal market but it does not cover all issues regulated by national consumer law. European law does not substitute national law but interacts with domestic legal orders. In fact, it covers so far essential cross-border issues such as the safety of consumer goods as well as the protection of the economic interests of consumers in a number of specific sectors harmonised by a number of adopted Directives. EU Member States transpose the EU dynamic *acquis* into national law and are obliged to put in place independent administrative structures which allow effective market surveillance and enforcement. Appropriate judicial and out-of-court dispute resolution mechanisms, consumer information and education, and a role for consumer organisations are to be ensured as well in this European consumer framework.<sup>6</sup>

### 2.1 European consumer law *acquis* on consumer rights, unfair contractual terms and commercial practices.

General principles of EU law in the field of contractual law and consumer law related to price-indexation clauses are established in two European Directives: the Directive 93/13/EEC on unfair contractual terms which states that these terms must be declared non-enforceable against consumers and the Directive 2005/29/EC on unfair commercial practices which inaugurates a general European duty for business to trade fairly and not to mislead consumers. Both have been incorporated to the EEA Agreement and they will be covered *infra*.

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Twigg-Flessner (ed.), *The Cambridge Companion to European Union Private Law*, Cambridge University Press, 2010, pp. 116-130; Grundmann, S. And Mazeaud, D. (eds), *General Clauses and Standards in European Contract Law*. Private law in Context Series. Comparative law, EC law and Contract Law Codification, Kluwer Law International, 2006; Lando, O and Beale, H. (eds), *The Principles of European Contract Law. Parts I and II*, The Hague 2000; Lando, O., Clive, E., Prüm, A. and Zimmermann, R. (eds). *The Principles of European Contract Law. Part III*, The Hague 2003; Lando, O., “The European Principles in an Integrated World“, *European Review of Contract Law* 2005, Volume 1, Issue 1, p. 18ff.

<sup>5</sup> This term is used in EU law to refer to the total body of EU law accumulated thus far. It means all law which has been acquired or adopted within the Community (both legislation and case-law from the Court of Justice of the EU).

<sup>6</sup> European Commission, Doc. SEC (2010) 153 and Doc. COM (2010) 62 from 24 February 2010. See also Annex XIX to the EEA Agreement which lists all EU acts incorporated to the EEA legal order as it stood on 1 May 2010. *De lege ferenda*, since the EU is reforming this field and Iceland has started negotiating accession to the EU in 2010 some changes will be expected concerning new legislation falling outside the EEA or not yet incorporated such as the new *acquis*.

A general principle set by these Directives is that under EU legislation any contractual clause that creates a significant imbalance in the parties' rights and obligations, to the detriment of the consumer is forbidden per se. Another general principle is that businesses have the obligation to trade fairly, avoiding unfair and misleading commercial practices.

Unfortunately, for the time being, the scope of EU law on good faith and unfair dealing is not general. The protection of the consumers is therefore partially achieved. The consumer *acquis* on contract law does not include yet a general duty to deal fairly or to act in good faith for all contracts on all cases. This is a principle that hopefully will be inaugurated when the European legislation is revised with a horizontal approach.

In the next section we will see that this general duty to deal fairly and act in good faith is in force concerning two cases: unfair contractual terms non-individually negotiated and unfair commercial practices. EU law clearly establishes in the two Directives that unfair contractual clauses non-negotiated individually (usually referred as "standard clauses") do not bound the consumers and that there is general duty to trade fairly when engaging in commercial practices addressed to consumers (marketing, advertising, etc).

In another section *infra* we will see how the judicial review done by the ECJ on unfair commercial clauses and practices primarily applies a test of unfairness and determines the legal consequences of unfair contractual terms favouring the protection of consumers. However, the ECJ has also reminded that, at the end, it is for the national courts to decide on the legality of the clauses taking into account the context of national legislation. Special mention will be made on the Case *Trummer* on foreign mortgages and free movement of capital in the internal market.<sup>7</sup>

European legislation is dynamic so that general EU consumer law is currently under reform. There is a process of legislative review of the Consumer *acquis* and a new proposal for a Directive on consumer rights (2008) which is now pending for adoption. However, in the field of consumer protection specifically related to financial services, mortgage credits on immovable property and indexation clauses, there is no specific *acquis* as the European institutions are still working on a separate legislation and policy. The new Consumer Credit Directive 2008/48/EC excludes from its scope credit agreements secured by mortgages on immovable property. At present there is consultation work under way to deal with mortgage credit at European level, following the Recommendation 2001/93/EC that has been incorporated into the EEA legal order.<sup>8</sup> In the absence of an specific *acquis*, the general EU consumer law remains applicable.

### *2.1.1 Applicability of the Directive 93/13/EC on unfair contractual terms (under revision). Focus on price indexation clauses.*

In the first place, it must be said that European consumer law offers a good general protection in particular with the Directive on unfair contractual terms which is currently under revision.<sup>9</sup> This legislation already generates far-reaching protection, though generally unintended, for consumers doing real estate transactions and contracting mortgages to that regard. Such conclusion is supported by the ECJ

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<sup>7</sup> ECJ. Case *Manfred Trummer and Peter Mayer* C-222/97. European Court Reports (from now on ECR) [1999] p. I-01661.

<sup>8</sup> Commission Recommendation 2001/193/EC of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans (OJ L 69, 10.3.2001, p. 25).

<sup>9</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. OJ L 095 , 21/04/1993 pp. 29-34.

case *Heininger*<sup>10</sup>, dealing with the consumer's right to withdraw from a real estate investment arrangement entered into on credit.

Directive 93/13/EEC has harmonised national provisions on unfair terms in consumer contracts at European level. A contractual term not individually negotiated (particularly in the context of a pre-formulated standard contract) shall be regarded as unfair if, contrary to good faith, it causes a significant imbalance in the parties' rights and obligations, to the detriment of the consumer. This principle is applicable to all kind of contracts. There has been some discussions in academic literature as to whether real property contracts were to be included or not. Final conclusion is given by the Consumer Law Compendium. The principle is also applicable to contracts on land and property such as credit mortgages for the acquisition of property.<sup>11</sup>

However, with the exception of the ECJ *Freiburger Kommunalbauten*<sup>12</sup> case, this question does not appear to have become a matter of discussion in praxis. In this case the ECJ ruled that it is for the national court to decide whether a contractual term satisfies or not the requirements for it to be regarded as unfair under the European Directive.<sup>13</sup>

The scope of the Directive 93/13/EC encompasses terms laying down, for instance, the manner of calculation and the procedures for altering the price of services and goods subject to a contract between a consumer and a professional.<sup>14</sup> Although the Directive prohibits in Annex 1 terms allowing the final price to be determined in the future, it allows however for an exception in Annex 2 Subparagraph (l). Price-indexation clauses are accepted on two conditions. First, they must be lawful or not prohibited by law and secondly, the method by which prices vary must be explicitly described in the contract. Consumers must therefore know in advance how the future price for the contract will be determined and calculated. Changes in the price must be predictable.

In order to assess the fairness of contractual terms, it is essential to take into account the approach adopted by the Consumer Law Compendium<sup>15</sup>. A term is

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<sup>10</sup> ECJ, Case *Heininger* C-481/99 [2001] ECR I-9945. The litigation turned on the question of whether real estate credit transactions, which were expressly excluded from the Consumer Credit Directive 87/102/EEC, could nevertheless be subsumed under the doorstep directive if the credit transaction was entered into or prepared in a 'doorstep situation'. At the time the litigation came before German courts, it was accepted legal that neither the Consumer Credit nor the Doorstep Directive applied to real estate credit transactions and that therefore the implementing German legislation was in conformity with European law. Therefore, the banks had not informed the consumer of an eventual right of cancellation, as required by Directive 85/577/EEC, because in their opinion no such right existed anyhow. In the *Heininger* case, proceedings brought before the ECJ by a reference from the highest German civil court, the *Bundesgerichtshof* (BGH), the ECJ found, to the surprise of most legal observers, to the opposite. The ECJ ruled that Directive 85/577/EEC is also applicable to real estate credit transactions because it is not expressly exempted, and such exemptions must be interpreted strictly in order not to frustrate the protective ambit of the directive.

<sup>11</sup> See paper from Remien, O, Real Property Law and European Private Law - A Sketch of an Unsurveyed Territory and Consumer Law Compendium on Directive 93/13/EC. This document mentions the judgment from a UK Court which reasoned that to exclude contracts relating to land from the scope of "goods and services" would go against the grain of the aim and purpose of the Directive, which is to provide a high level of protection. See for further reference the CA judgment of 24 February 2004 - *Khatun & Others v. Newham LBC* [2004] EWCA Civ 55.

<sup>12</sup> Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co. KG v Ludger Hofstetter et Ulrike Hofstetter* [2004] ECR I-3403.

<sup>13</sup> Poncibò, C., "Some Thoughts On The Methodological Approach To EC Consumer Law Reform", *Loyola Consumer Law Review*, 2009, Vol. 21, Issue 3, pp. 353-371, on p. 358.

<sup>14</sup> EFTA Surveillance Authority, Report on the Application of Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts. Document No: 01-9395-D, on pages 5 and 12.

<sup>15</sup> The EC Consumer Law Compendium is a study prepared for the European Commission by an international research group where the transposition of 8 important consumer directives into the national laws of 27 Member States is analysed. The findings of this study reveal the substantial differences between the various national implementing measures as a result of utilising minimum harmonisation clauses and regulatory options. [http://ec.europa.eu/consumers/rights/docs/-consumer\\_law\\_compendium\\_comparative\\_analysis\\_en\\_final.pdf](http://ec.europa.eu/consumers/rights/docs/-consumer_law_compendium_comparative_analysis_en_final.pdf)

considered to be unfair because of its effects on the economic interests of the consumer. While assessing the fairness of contractual terms, regard has to be paid not only to the circumstances prevailing at the time of conclusion of the contract (as the Directive provides as a minimum), but also to conditions following conclusion of the contract (change of circumstances).

The ECJ in its case law on this Directive primarily applies the “abuse theory”. According to the ECJ in the cases *Óceano Grupo Editorial*<sup>16</sup> and *Mostaza Claro v. Milenium*,<sup>17</sup> the system of protection introduced by Directive 93/13 is designed from a consumers’ perspective:

“is based on the idea that the consumer is in a weak position vis-à-vis the seller or supplier, as regards both his bargaining power and his level of knowledge. This leads to the consumer agreeing to terms drawn up in advance by the seller or supplier without being able to influence the content of the terms.”

Furthermore, as it is reflected on the ECJ case *Óceano* referred supra, the Court notes that the use of terms which lead to a significant imbalance in the contractual relations between the parties undermines not only the interests of the consenting party but also the legal and economic order as a whole.<sup>18</sup> The Court acknowledges therefore that consumer law has a different nature than commercial, business or financial law and that this different nature, biased towards the weakest parties, is important both for the market and from a social point of view.<sup>19</sup>

In another case *Cofidis*,<sup>20</sup> the ECJ extended the competence of judges to review consumer law even further and stated that the protection of the consumers precludes any national provision which prohibits the national court, on expiry of a limitation period, from finding that a term of the contract is unfair. In contrast to the *Óceano* case, the dicta of the ECJ is related not only to the issue of whether the national court can review its jurisdiction “on its own motion”, but on the nullity of clauses generally. It is therefore to be assumed that, according to the view of the ECJ, national courts must have the power to review the fairness of a clause on their own initiative generally (and not only when jurisdiction clauses or disputes arise). This has been reaffirmed in a recent case *Pannon GSM Zrt. v. Erzsébet Sustikéné Gyórfi* where the ECJ rules that national courts are required to examine, of their own motion, the unfairness of a term contained in a contract concluded between a consumer and a seller or supplier.<sup>21</sup> Under EU law, national judges also have the competence to do judicial review of national legislation in order to determine whether it complies or not with the European provisions. In case the domestic legislation does not respect with EU law, national judges have to duty to set it aside or not to apply it.<sup>22</sup>

The concept of absolute nullity of the unfair clause is established clearly by EU law. The whole contract remains binding on both parties, so long as this is possible

<sup>16</sup> ECJ, Joint cases C-240/98 to C-244/98, *Océano Grupo Editorial, S.A. and Salvat Editores, S.A. v. Rocío Murciano Quintero et al.* [2000] ECR I-04941

<sup>17</sup> See as well ECJ judgment of 26 October 2006, C-168/05 –*Elisa María Mostaza Claro v. Centro Móvil Milenium SL* [2006] ECR I-10421, para. (25).

<sup>18</sup> Advocate-General Saggio emphasised this point in his Opinion of 16 December 1999 [EC], Joint cases C-240/98 to C-244/98, *Océano Grupo Editorial al.* [2000] ECR I-04941.

<sup>19</sup> On the importance of consumer law for social justice see in the bibliography the research published by Prof. Micklitz from the European University Institute.

<sup>20</sup> ECJ judgment of 21 November 2002, C-473/00 - *Cofidis v. Fredout*, [2002] ECR I-10875.

<sup>21</sup> In this case the ECJ recalls, first, that the protection which the Directive confers on consumers extends to cases in which a consumer who has concluded with a seller or supplier a contract containing an unfair term fails to raise the unfairness of the term, whether because he is unaware of his rights or because he is deterred from enforcing them on account of the costs which judicial proceedings would involve. See ECJ, Judgment of the Court of Justice of 4 June 2009 in Case C-243/08 *Pannon GSM Zrt. v. Erzsébet Sustikéné Gyórfi*, [2009] ECR not yet reported.

<sup>22</sup> ECJ, case *Simmenthal* 106/77 [1978] ECR 629.

without the offending clause according to the purpose and legal nature of the contract. The nullity is thus a rule limited to the unreasonable term.<sup>23</sup>

To conclude this section, it can be said that as the EU *acquis* stands today, unfair terms in consumer contracts not individually negotiated are unlawful (are to be declared null and void). Price-indexation clauses must be, first, legal and, secondly, they must also determine explicitly the method of calculation for future payments. This provision applies to all contracts according to the case-law of the ECJ. Member States can decide on a higher level of protection regarding financial services and house mortgages as this Directive sets only a minimum threshold of harmonisation.<sup>24</sup> While the minimum protection must be guaranteed by all EU Member States, a higher protection can be afforded at national level. According to the EU Treaties, judges, governments and national legislators can never lower the standard of protection that EU law affords consumers. The diversity of national law is only allowed to the extent that it ameliorates the minimum European protection.

This Directive is in force but is currently under revision. A new proposal for a Directive on Consumer Rights has been presented by the European Commission.<sup>25</sup> It is still unclear whether this new proposal will include in its scope credit mortgage on immovable property or not. The European Commission is working on a separate policy on consumer mortgage credit following its Recommendation 2001/93/ EC that will be examined *infra*.

#### *2.1.2 Applicability of the Directive 2005/29/EC on unfair commercial terms.*

Together with the Directive 93/13/EC on unfair contractual terms, another Directive is essential as it deals with the marketing, advertising and selling practices. Directive 2005/29/EC has simplified existing EU legislation concerning unfair commercial practices which are now prohibited under Article 5 of this Directive.<sup>26</sup> Unfair commercial practices can be of different sorts (misleading and aggressive practices, ‘sharp practices’, such as pressure selling, misleading marketing and unfair advertising, and practices which use coercion as a means of selling). All these practices are prohibited, irrespective of the place of purchase or sale. This Directive, furthermore, states clearly the concept of a “duty to trade fairly” for businesses.<sup>27</sup>

Like it was the case before, this legislation has imposed a duty to trade fairly with a horizontal approach. Still it has to be remembered that it does not apply to the substance of the contracts. Being the complement of Directive 93/13/EC, it applies to advertising, promotions, marketing, webpages, etc. When these commercial practices are unfair or reflect unfair or abusive substantive clauses, they are deemed

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<sup>23</sup> Consumer Law Compendium, on p. 406. [http://ec.europa.eu/consumers/rights/docs/-consumer\\_law\\_compendium\\_comparative\\_analysis\\_en\\_final.pdf](http://ec.europa.eu/consumers/rights/docs/-consumer_law_compendium_comparative_analysis_en_final.pdf)

<sup>24</sup> Most important case-law from the ECJ regarding this Directive: Case C 243/08 *Pannon GSM Zrt. v Erzsébet Sustikné Györfi* [2009] ECR nyr, Case C-168/05 *Elisa María Mostaza Claro v Centro Móvil Milenium SL* [2006] ECR I-10421; Case C-302/04 *Ynos kéft v János Varga* [2006] ECR I-371; Case C-237/02 *Freiburger Kommunalbauten GmbH Baugesellschaft & Co. KG v Ludger Hofstetter et Ulrike Hofstetter* [2004] ECR I-3403 ; and Case C-473/00 *Océano Grupo/ Cofidis SA v Jean-Louis Fredout* [2002] ECR I-10875.

<sup>25</sup> European Commission, Proposal for an EC directive on consumer rights. Doc. COM (2008) 614 from 8.10.2008.

<sup>26</sup> Directive 2005/29/EC of the European Parliament and of The Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market. OJ L 149 from 11.6.2005.

<sup>27</sup> Article 4 expressly prohibits Member States from maintaining or adopting more restrictive national measures, even where such measures are designed to ensure a higher level of consumer protection if these rules interfere with the internal market: freedom to provide services and/or free movement of goods but only for reasons falling within the field approximated by this Directive. Article 5 of the Directive prohibits in general unfair commercial practices and provides a definition. Article 6 of the Directive describes misleading actions. Article 7 incorporates misleading omissions which are prohibited.



unlawful. It is important to remember that unfair commercial practices point to the existence of bad faith with regards to the professional offering the services or goods.

Regarding the scope of the Directive, some explanation must be done. In Article 3.2. it is established that this Directive is without prejudice to contract law and, in particular, to the rules on the validity, formation or effect of a contract. In Article 3.9. it reads that, in relation to ‘financial services, as defined in Directive 2002/65/EC and immovable property, Member States may impose requirements which are more restrictive or prescriptive than this Directive offering better consumer protection.

This is an important clarification in its scope. Article 4 contains a general rule on “maximum harmonisation“ which has been unusual so far in consumer law. It expressly provides that Member States may not adopt stricter rules than those provided for in the Directive, even in order to achieve a higher level of consumer protection. There are now uniform rules on those unfair business-to-consumer commercial practices which have been harmonised as the ECJ has declared in the cases *VTB-VAB* and *Galatea* and other recent jurisprudence.<sup>28</sup> This is done to prevent national legal obstacles (regulations of commercial practices) to the functioning of the European internal market.

However, regarding financial services and immovable property, an exception to the general rule established by Article 4 is done. We therefore return to the normal standard of EU consumer law of “minimum harmonisation“. In the field of financial services and immovable property, Member States can go further than the uniform provisions established in the Directive and can offer a higher level of consumer protection regarding unfair commercial practices.<sup>29</sup>

What must be clear under EU law is that if a unfair contractual term is null and void under Directive 93/13/EC, commercial institutions should not be allowed to use unfair commercial practices (advertising, promotions and marketing) to lure consumers into signing these contracts. It is also clear that in the relation to financial services and immovable property Member States can increase consumer protection but can never decrease it.

To conclude this section, it can be said that this Directive has a general nature. As it has not harmonised specifically at European level commercial practices on credit mortgages, these can be regulated with a higher strict standard in national law. For the time being, consumers can rely on the uniform rules and general principles of the Directive and then refer to more specific national provisions for further specific protection. The EU legal framework and the national consumer law must peacefully coexist. The Commission has also announced its decision to develop a horizontal initiative on unfair commercial practices in the field of retail financial services including mortgage credit.<sup>30</sup> As it is the case in national law, the EU Treaties establish that future EU legislation can only improve the level of protection afforded to consumers, EU law does not allow European institutions and/or Member States to lower the current standards.

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<sup>28</sup> ECJ, Judgment of the Court (First Chamber) of 23 April 2009. *VTB-VAB NV v Total Belgium NV* and *Galatea BVBA v Sanoma Magazines Belgium NV*. Joined cases C-261/07 and C-299/07. ECR [2009] not yet reported. See also Judgment of the Court (First Chamber) of 14 January 2010. *Zentrale zur Bekämpfung unlauteren Wettbewerbs eV v Plus Warenhandels-gesellschaft mbH*. Case C-304/08. ECR [2010] not yet reported and Judgment of the Court (Third Chamber) of 11 March 2010. *Telekomunikacja Polska SA w Warszawie v Prezes Urzędu Komunikacji Elektronicznej* Case C-522/08. ECR [2010] not yet reported.

<sup>29</sup> Micklitz, H-W., “Unfair commercial practices and misleading advertising“, in Micklitz, H-M., Reich, N. and Rott, P., *Understanding EU Consumer Law*, Intersentia, 2009, pp. 61-117, on p. 78.

<sup>30</sup> European Commission. White Paper on the Integration of EU Mortgage Credit Markets. Doc COM (2007) 807 final.

*2.1.3 Applicability of Recommendation 2001/93/EC on pre-contractual information to be given to consumers by lenders offering home loans.*

In the field of financial services and home loans, a non-binding instrument has been already adopted at European level which is the Recommendation 2001/193/EC on pre-contractual information to be given to consumers by lenders offering home loans (Code of Conduct) and the use of the European Standardised Information Sheet (ESIS).<sup>31</sup> It aims to ensure that consumers obtain transparent and comparable information on housing loans.

This recommendation covers pre-contractual consumer information for domestic and cross-border home loans. According to the recommendation, the lender should supply to the consumer in the course of the pre-contractual phase with general information set out in Annex I and personalised information to be presented in a European Standardised Information Sheet as set out in Annex II. In addition, the lender should supply to the consumer information on the identification of the competent body to which the consumer can refer in the event of difficulties in relation to the application of the Code on pre-contractual information for home loans. Member States and lenders offering home loans in the Community are invited to comply with this recommendation.

This Code of Conduct and Information Sheets appear to have been implemented with varying degrees of success across EU Member States, yet without solving the overall problem of a lack of a common legal framework.<sup>32</sup> For this reason, the European Parliament has called for greater harmonisation of provisions on pre-contractual information, which are necessary to enable borrowers to take informed decisions on potential mortgage contracts. The Parliament has insisted that such pre-contractual information must be accurate and comprehensible to allow an informed choice, and that it should give the consumer as comprehensible and global a picture as possible in the light of the available information on which the mortgage contract is based.

In short, the European Parliament considers the Code of Conduct and the Information Sheets to be important yet insufficient instruments for the protecting the economic interests of citizens contracting home loans, specially those citizens who find themselves in cross-border situations.<sup>33</sup>

*2.1.4 Review of the Consumer acquis. Proposal for a Directive on consumer rights (2008). Discussions on the applicability to mortgage credit.*

As explained above, the existing consumer protection legislation is, in general, based on minimum harmonisation and allows Member States to introduce more stringent legislation. This approach has not been totally successful so far. For this reason, the European Commission launched a public consultation on the revision of the consumer acquis in 2007 by adopting a Green Paper<sup>34</sup> for discussion. Following that consultation, the European Commission proposed a new horizontal Directive on consumer rights which advances the consolidated acquis and reforms several Directives<sup>35</sup> and is developing other initiatives in the general field of consumer protection, such as the EU Consumer Compendium.<sup>36</sup>

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<sup>31</sup> Commission Recommendation 2001/193/EC of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans (OJ L 69, 10.3.2001, p. 25).

<sup>32</sup> European Parliament resolution on mortgage credit in the EU (2006/2102(INI)) OJ C 314E , 21.12.2006, p.136–142, on p. 138.

<sup>33</sup> Ibidem on p. 139.

<sup>34</sup> European Commission, Green paper on the Review of the Consumer Acquis. Doc. COM (2006) 744 final. OJ C 61 15.3.2007.

<sup>35</sup> European Commission, Proposal for an EC directive on consumer rights. Doc COM (2008) 614. The proposal aims to revise four existing directives on consumer contracts (the cornerstones of EU

At the moment the proposal for a Directive on Consumer Rights from 2008 is awaiting Parliament decision in a first reading.<sup>37</sup> Within the Council, a large number of EU Member States think that there are specific areas which should not be covered by some or all parts of the directive, such as contracts on immovable property and financial services because they need a separate policy. Clarification is also deemed necessary in order to determine the scope of the directive, the coherence with other EU legislation and the interaction with the general contract law of the Member States and even with European contract law.<sup>38</sup>

EU Consumer law is therefore evolving and under continuous reform. In the future, the minimum harmonization approach (i.e. Member States may maintain or adopt stricter consumer protection rules) adopted in the previous EU legislation in the field will be abandoned in order to avoid fragmentation in the level of consumer protection in the Member States. A new general horizontal approach aiming for a full protection of consumers has been inaugurated and this is an approach that hopefully will cover all existing gaps.<sup>39</sup> What is still unclear for the time being is the substance of the future corpus of European law applicable to consumers in the field of financial services and, more specifically, how mortgage credits will be considered in the EU legal order from a consumer perspective. While the new policy is determined and new legislation drafted, the Recommendation 2001/93 on pre-contractual information to be given to consumers by lenders offering home loans is applicable. And, of course, general EU consumer law as well as national consumer legislation remain in force.

## 2.2. European consumer law *non-acquis* on financial services and mortgage credits on immovable property

As explained in the previous section, notwithstanding the general EU consumer *acquis*, it must be said that - in the field of consumer protection specifically related to financial services, mortgage credits on immovable property and indexation clauses- there is no specific *acquis* legally binding. In fact, the European institutions are still working on a separate legislation and policy to complement the Recommendation from 2001. This policy will be mentioned *infra*.

While there is general agreement that mortgage credits need urgent attention both at European and national level,<sup>40</sup> the EU has so far guaranteed a limited and minimum standard of consumer protection specifically in this field. In fact, the only real European specific initiative is the European Standard Information Sheet (ESIS), a standardised information sheet which aims to improve the presentation of precontractual information to consumers. Unfortunately, it is not mandatory and this weakens its applicability.

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legislation in the field: Dir. 85/577/EEC on contracts negotiated away from business premises, Dir. 93/13/EEC on unfair terms in consumer contracts, Dir. 97/7/EC on distance contracts, Dir. 1999/44/EC on consumer sales and guarantees) merging them into a single horizontal instrument based on full-harmonisation (i.e. Member States cannot maintain or adopt provisions diverging from those laid down in the Directive), which regulates the common aspects in a systematic fashion, simplifying and updating the existing rules, removing inconsistencies and closing gaps.

<sup>36</sup> European Union. Consumer Law Compendium. Doc. available at [http://ec.europa.eu/consumers/-rights/docs/consumer\\_law\\_compendium\\_comparative\\_analysis\\_en\\_final.pdf](http://ec.europa.eu/consumers/-rights/docs/consumer_law_compendium_comparative_analysis_en_final.pdf).

<sup>37</sup> European Parliament. Draft Report by the Committee on Internal Market and Consumer Protection. Doc PE442.789 from 20.05.2010.

<sup>38</sup> Council of the European Union, Press Release 2982nd Council meeting, Brussels 3-4 December 2009.

<sup>39</sup> For a commentary on the proposal see Poncibò, C., "Some Thoughts On The Methodological Approach To EC Consumer Law Reform", *Loyola Consumer Law Review*, 2009, Vol. 21, Issue 3, pp. 353-371; and Whittaker, S., "Unfair Contract Terms and Consumer Guarantees: the Proposal for a Directive on Consumer Rights and the Significance of 'Full Harmonisation'", *European Review of Contract Law*, 2009, Volume 5, Issue 3, pp. 223-247.

<sup>40</sup> European Parliament. Report on Mortgage Credit in the EU from 19.10.2006. OJ C 314E , 21.12.2006, p. 136-142.

At the time of writing, EU general consumer law is nevertheless applicable to the specific field of consumer credit unless stated otherwise. More worrisome is the fact, as EU legislation seems to be evolving, that an entire new exemption has been created for credit agreements which are secured either by a mortgage or by other comparable security or right related to immovable property by the new Directive 2008/48/EC to be examined infra. This could be a problem if the European Union did not adopt in a parallel way a separate legislation for this field. This is a critic seriously put forward by the leading specialists in the field of consumer law.<sup>41</sup>

*2.2.1 Non applicability of the new Consumer Credit Directive 2008/48/EC: exclusion of credit agreements secured by mortgages on immovable property.*

The new Directive 2008/48/EC updates existing EU rules on consumer credit,<sup>42</sup> by recasting the existing Directives on consumer credit 87/102, 90/88 and 98/8. It concerns credit agreements for loans of between €200 and €75,000 but does not apply to a number of credit agreements secured by immovable property, forms of overdraft facility, private credit agreements and those between employer and employee. It aims to ensure that consumers are provided with enough information prior to and on conclusion of the contract to allow them to make informed decisions and it allows a consumer 14 days to withdraw from the credit agreement without having to give reasons. It also limits compensation consumers must pay to banks in the event of early repayment.

Why does the new Consumer Credit Directive 2008/48/EC exclude from its scope credit agreements secured by mortgages on immovable property? The Commission has insisted that these types of credit agreements are so different from normal credit contracts that they should be regulated in a separate legal instrument. Furthermore, all specialists agree that they touch upon difficult questions of contract and property law which need very careful consideration. We will therefore have to follow the work announced by the EU institutions very closely. While a policy is adopted, general EU consumer law and the Recommendation 2001/93/EC (Code of Conduct and Information Sheets) are still applicable. Specific comments on some questions related to contract law are offered infra.

*2.2.2 Jurisprudence from the ECJ. Comment on the Case Trummer and Mayer on foreign mortgages and free movement of capital in the internal market.*

Although there is a rich jurisprudence from the ECJ on Directives 93/13/EC on unfair contractual terms and Directive 2005/29/EC on unfair commercial practices, there is only one case so far where the Court of Justice has ruled on foreign mortgages in the context of European Law. In the case *Trummer and Mayer*<sup>43</sup> the Court declared that an obligation to have recourse to the national currency for the purposes of creating a mortgage could be a restriction on the movement of capital.<sup>44</sup> The ECJ ruled that mortgages can be, but do not have necessarily to be, considered as capital movements falling under EU law. In order for the European law of the internal market to apply there must be a community or European cross-border dimension to the capital or payment movement.<sup>45</sup>

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<sup>41</sup> Micklitz, H-M, Reich, N and Rott, P, *Understanding EU Consumer Law*, Intersentia, 2009, p. 189.

<sup>42</sup> Directive 2008/48 on credit agreements for consumers and repealing Council Directive 87/102, OJ L133/66 from 22.05. 2008. Corrigendum to Directive 2008/48 OJ L207/14 from 11.09.2009

<sup>43</sup> ECJ. Case *Manfred Trummer and Peter Mayer* C-222/97. ECR [1999] p. I-01661.

<sup>44</sup> Akkermans, Bram, Property Law and the Internal Market in Sjeff van Erp, Bram Akkermans (eds.), *CFR and Property Law*, forthcoming. Available at SSRN: <http://ssrn.com/abstract=1436496>

<sup>45</sup> A resident in Germany sold to a resident in Austria a share in the ownership of a property situated in Austria, the purchase price was agreed by the parties in German marks which were later replaced by the euro. They agreed that a mortgage should be created to secure payment of the purchase price but

What is interesting in this case *Trummer and Mayer* are the statements from Advocate General La Pergola where he defines the competence of Member States in this area, elaborating on the nature of the mortgage, the necessary link between the financial obligation, the lien/property secured, the inherent risks of this kind of mortgages for consumers and indicating that the final test under EU law to justify or not national legislation on foreign mortgages will be one of proportionality:

[...] the mortgage is one of the most classical ways of guaranteeing an obligation. If the distinguishing mark of a mortgage is considered to be its accessory nature, its fate will be inextricably linked with that of the obligation it guarantees. Let us pause to consider this notion. Precisely because the accessory follows the principal, the mortgage must, for the purposes of the present case, be considered strictly in relation to the transaction for the existence (or effectiveness) of which it is an essential precondition.

At this juncture, however, it is necessary to consider whether overriding factors such as those mentioned in Article 73d of the Treaty may nevertheless justify the maintenance of legislation such as the Austrian law at issue in the present dispute.

This calls for a number of remarks. It has been pointed out in this context that the national legislature needs to safeguard mandatory requirements, such as certainty as to the value of the lien. Reference has also been made to the difficulty for lower-ranking mortgage creditors in ascertaining the precise value of their own lien when the higher-ranking mortgage is registered in a foreign currency, both because of the difficulty of establishing the exact value of the currency in which the higher-ranking mortgage has been created and because of the risk of variation in the exchange rate between the currency of registration and the currency which is legal tender in the country in question.

Admittedly, there is the other aspect to the question, which relates to the difficulty of establishing the value of the foreign currency or to the extreme volatility of its value in relation to the national currency, on the assumption that the latter, by contrast, displays a degree of stability. The considerations involved here are far from negligible. Moreover, Article 73b treats the currencies of all countries, whether Community Member States or not, as equivalent for the purposes of the free movement of capital. In addition, Article 73d contains a reservation which permits Member States 'to take measures which are justified on grounds of public policy or public security'. In order to safeguard the overriding requirements to which Article 73d refers, the national legislature is therefore authorised to introduce measures which restrict the free movement of capital. Let me be more specific. The justifying criterion that comes to mind in this regard is that of proportionality. In view of the requirements of public policy or public security on which they may have been based, the measures adopted by the Austrian legislature should be considered compatible with the Treaty only if they are reasonable and proportionate to the objective pursued.

As it is usual in the case-law of the Court of Justice, at the end a balance was found between the freedom of the parties regarding movement of capital and the public interest to be protected. The balancing instrument was the principle of proportionality. While the EJC recognised the right of a Member State to require a mortgage to be expressed in the national currency for several reasons (public policy, creditor protection and ensuring transparency of the system) the ECJ held that – in the concrete case – the principle of proportionality had not been respected and the restriction was not duly justified. Parties were forced to express their security right in terms of the national Austrian currency and this had deprived them of an element of

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an application for registration of the mortgage in the Austrian land register was refused on the ground that the debt was denominated in a foreign currency. The EJC ruled that Austrian rules were liable to dissuade the parties concerned from denominating a debt in the currency of another EU State, thereby depriving them of a right of free movement of capital and payments.

the free movement of capital. The provision of Austrian law was declared contrary to EU law as the ECJ found no valid grounds for a justification of such restriction in the circumstances of the case.<sup>46</sup>

According to Akkermans and Bram, this judgement could have meant some progress in the creation of the single market in financial services and mortgage credit, an important segment of the EU financial market that had fallen outside EU harmonisation.<sup>47</sup> Although this has not yet happened, it was on the basis of free movement of capital together with this judgment, that it became possible for example to secure a mortgage over a property situated in Iceland and raise a loan in another EU currency such as the Euro, Sterling Pound or Danish Kronor or even in non-EU currencies (as the free movement of capital and payments is the only internal market freedom that also applies to third countries). This is so because the principle of homogeneity between EU and EEA law legal orders is an essential pillar of the European legal order.<sup>48</sup> This explains the legislative choice of the Icelandic Parliament. According to Icelandic law,<sup>49</sup> it is possible to contract a home loan in a foreign currency secured by a property in Iceland and pay monthly instalments in that currency. What is prohibited is to contract a home loan denominated in Icelandic krónas (where no real exchange of foreign currency takes place between lender and borrower) and link the payment of both the capital and the interest to the fluctuations of foreign currencies as the Supreme Court has ruled in June and September 2010.

### *2.2.3 Work under way to deal with mortgage credit at European level— current trends.*

As we have seen, in spite of the importance of the problems raised there is not yet any European specific legislation or practice dealing specifically with consumer problems linked to mortgage credit such as foreign mortgages, foreign currency mortgages and/or mortgages linked to foreign currencies. The protection of consumers in the field of financial services (credit and mortgages) still falls primarily under general EU consumer law and under general and specific national laws. As a result, protection of consumers is fragmented and sometimes unclear both at European and national level.<sup>50</sup>

There is work under way to advance the integration of mortgage credit markets and law at European level. Mention must be made of the Green Paper on Mortgage Credit on the EU<sup>51</sup> and the White Paper on the integration of EU Mortgage Credit

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<sup>46</sup> Advocate General La Pergola in his opinion on the case *Trummer and Mayer* recognises the risks associated to foreign currency mortgages admitting a general regulatory scope for the EU Member States which might prohibit them and derogate from the free movement of capital. But, in that regard, the principle of proportionality must be applied on a case by case basis. Opinion delivered on 6 October 1998. ECJ. Case *Manfred Trummer and Peter Mayer* C-222/97. [1999] ECR p. I-01661.

<sup>47</sup> See Sideek Mohamed, "A Critical Assessment of the ECJ Judgement in *Trummer and Mayer*", (1999) 14 JIBFL 396. According to this author, attempts to develop a single market in mortgage services reached a legislative deadlock due to the lack of political enthusiasm in the Council to adopt any meaningful legal measures for its liberalisation. The European Commission for example proposed unsuccessfully a directive on the freedom of establishment and the free supply of services in the field of mortgage credit. See Doc. COM/1984/730/FINAL on the right of establishment and freedom to provide services. OJ C/1985/42/4. On this draft directive, see for further reference Marco Radice, "A Proposal For An EC Directive Concerning The Liberalization of Mortgage Credit In Line With The Second Banking Directive", (1994) 1 LIEI 155.

<sup>48</sup> M. Elvira Méndez-Pinedo, *EC and EEA Law*, Europa Law Publishing, 2009.

<sup>49</sup> Act no. 38/2001.

<sup>50</sup> Ása Ólafsdóttir and Eiríkur Jónsson, *Staða neytendamála á Íslandi*, Skýrsla Lagastofnunar HÍ, Apríl 2008, 141-240.

<sup>51</sup> European Commission. Green Paper Mortgage Credit in the EU. Doc COM (2005) final.

Markets.<sup>52</sup> In parallel to the Commission initiatives we also find the Report on the Green Paper on Mortgage Credit done by the European Parliament.<sup>53</sup>

To understand why progress is slow, it is useful to remember some statements done by the Forum of discussion on financial services and protection of consumers, where several issues have been discussed.<sup>54</sup> This forum pointed out that “traditional” consumer protection law might be understood as a relatively coherent set of rules, which is often put together in a national consumer code or systematically integrated in national civil codes but the same cannot be said with regard to consumer credit law. In financial services, consumer protection rules are scattered over a large number of laws and regulations which makes it a difficult and complex area.<sup>55</sup>

[...]The financial services area is characterised by its high complexity and ever changing legislation. Financial products are very difficult to understand for non specialised lawyers and all the more so for most consumers. The situation is made worse by the banks not informing consumers properly on the characteristics of the services they buy. Financial services are usually outside the education and training of young lawyers. Expertise is needed and must be built up. This requires cooperation between lawyers and economists. Such expertise is a scarce commodity in the consumer movement – and even more so in the case of the smaller Member States.

Financial services are *per se* international and cross-border and so are the consumer problems they give rise to. Financial service providers are often operating on a world-wide basis – as the recent worldwide financial crisis has highlighted. Local consumer problems therefore can bear an inherent transnational dimension.

The European Commission declared that in its White Paper on Mortgage Credit its intentions to study the potential integration of the EU mortgage market and the benefits for European consumers.<sup>56</sup> According to the Commission, the notions of pre-contractual information and independent legal advice are essential without forgetting the principles of responsible lending and borrowing. This seems to be the policy currently being considered at European level.

Academic literature in EU law is almost non-existent concerning the treatment of foreign (currency) mortgages from a European perspective as only general studies on consumer credit and mortgage law have been published so far. Volante<sup>57</sup> has evaluated the issues addressed by the Commission in its Green Paper as well as the problems involved in any regulation of mortgage agreements and suggested that consumer protection with regard to these contracts should be focused on a test of the fairness of their terms, which could be based on the balance of risks the terms create

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<sup>52</sup> European Commission. White Paper on the Integration of EU Mortgage Credit Markets. Doc. COM (2007) 807 final.

<sup>53</sup> European Parliament. Report on Mortgage Credit in the EU (2006/2102(INI)). OJ C 314E , 21.12.2006, p. 136–142.

<sup>54</sup> Document available at [http://www.clef-project.eu/media/d\\_CLEFguidelinesonfinancialservices-\\_final\\_96344.pdf](http://www.clef-project.eu/media/d_CLEFguidelinesonfinancialservices-_final_96344.pdf)

<sup>55</sup> The Association EUROFI has reminded all actors about the importance of the European harmonisation in the field of financial services. According to EUROFI group: “Certain characteristics of retail financial services explain why consumer protection is a strong issue for these products: The “products” and services are intangible, and their features, quality and performance can be complex or difficult to understand for consumers. Consumers buy certain of these products relatively rarely, thus making it difficult to learn from experience (ex: mortgages, long term savings...). The effect or benefit of the 'product may not be apparent for many years in certain cases (e.g. a life assurance policy or pension) and is not easily predictable. Consumers should be prevented from going into over-indebtedness.“ See Eurofi group. Consumer protection. Document available at [http://www.-eurofi.net/pdf/Consumer\\_protection\\_en.pdf](http://www.-eurofi.net/pdf/Consumer_protection_en.pdf)

<sup>56</sup> European Commission. White Paper on Mortgage Credit. Doc. COM (2007) 807 final p. 4.

<sup>57</sup> Volante, Raffaele, “Mortgage credit contracts and the Green Paper on Mortgage Credit – Controls on Transparency and Fairness”, *European Review of Contract Law*, 2007, Volume 3, Issue 2, pp. 150–178.

between the parties. Volante has also pointed out some dangers relating to the opening up of the markets which need to be carefully assessed.<sup>58</sup>

In view of the complexities of the area, all EU legislative institutions agree that a European approach is needed but a stronger coordination must be done of consumer and contract law issues.<sup>59</sup> While the Commission's White Paper on the integration of EU mortgage credit markets considered the need for further assessment of policy options to increase market transparency and to ensure that consumers have a greater level of certainty as regards the recovery value of their mortgage investment; the Commission also announced in 2008 that it would first examine how to improve the quality of information provided to consumers in the field of mortgage credit and it would then study other aspects related to it such as responsible lending and borrowing. The Commission has recently indicated that it will not take any decision on the introduction of legislative measures until it has carried out further consultation and impact assessment,<sup>60</sup> as the European Parliament had requested in its Report on Mortgage Credit in the EU.<sup>61</sup> Last but not least, the financial crisis may have a potential impact on EU policy as the Commission has recently declared that it is considering introducing penalties on foreign currency loans due to the higher risk they pose to consumers.<sup>62</sup>

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<sup>58</sup> *Ibidem*. See the abstract: "Through the 2005 Green Paper on Mortgage Credit the European Commission opened a broad debate about which aspects of secured lending should be subject to uniform regulation throughout the European Union in order to increase the availability for consumers of one Member State of credit offered by lenders of a different Member State, thus achieving a fully integrated Internal Market in this important sector. The opening of national markets might, however, let more unscrupulous lenders issue credit on unfair conditions, in order to get more assets to use for securitization; this financial technique radically changed the US mortgage sector in recent decades and it is of increasing importance in Europe too."

<sup>59</sup> See European Parliament, DG for Internal Policies. Policy Department C. Citizens' Rights and Constitutional Affairs. "A comparison between the provisions of the draft Common Frame of Reference and the European Commission's proposal for a Consumer Rights Directive". Study. Doc PE 419.608.

<sup>60</sup> Council Conclusions of 14 May 2008 on Commission White Paper from 18 December 2007 support Commission intention to assess benefits and costs of different policy options. The European Commission is currently examining quality of information in mortgage credit in Europe and there is a Commission staff working document from 16 December 2008 and a Commission study on Equity Release Schemes in the EU from 18 March 2009. Feedback on the role and regulation of non-credit institutions in EU mortgage markets was given on 30 March 2009. A Commission working paper on best practices is expected in 2010. On 30 November 2009 the Commission published the results of the consultation on responsible lending and borrowing. Commission's services are currently considering whether a package of combined measures can be presented covering both mortgages and responsible lending. Information stated in Report of the UK Law Societies, Joint Brussels Office, *EU Legislation on Consumer Protection*, March 2010. For official information from the European Commission and the latest news on mortgage credit policy at European level see [http://ec.europa.eu/internal\\_market/finservices-retail/credit/mortgage\\_en.htm](http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm)

<sup>61</sup> European Parliament resolution on mortgage credit in the EU from 21.12.2006. OJ C 314E , 21.12.2006, p. 136–142.

<sup>62</sup> Tait, N. And Cienski, J., "EU eyes foreign currency loan penalties", article in Financial Times 3.09.2009. The Commission wants to introduce "specific and penal" capital requirements on lenders to prevent the granting of excessive loans to private households when these are denominated in a currency other than that of the borrower's income. Foreign exchange loans have also been a problem in Poland, Hungary, Romania and the Baltic states. See also Groendal, B., "E. Europe banks, regulators head for FX loan fight", article in Reuters 28.09.2009, who reports that European Central Bank governing council member Ewald Nowotny called for tighter restrictions on foreign currency lending in eastern Europe, saying it had no place in credit for ordinary consumers.



### 3. Are general principles of European consumer and contractual law applicable to financial services and house mortgages in the EEA and Iceland?

The EEA Agreement with its annex IXI incorporates almost all the EU consumer law *acquis* into the EEA legal order. Following the proper adoption of domestic legislation, this EU/EEA consumer *acquis* becomes fully applicable in Iceland. The Preamble of the EEA Agreement states that Contracting Parties are “DETERMINED to promote the interests of consumers and to strengthen their position in the market place, aiming at a high level of consumer protection;”. Annex XIX EEA Agreement specifically incorporates a number of EC legislative acts on Consumer Protection and is updated regularly by decisions of the EEA Joint Committee.<sup>63</sup>

As the Icelandic Administration has summarised in its reply to the European Commission on the applicability of EU/EEA consumer law in Iceland:<sup>64</sup>

“EU legislation in the field of consumer protection has been incorporated into the EEA Agreement and EU directives on consumer protection have been transposed into Icelandic legislation. Accordingly, consumer protection legislation in Iceland is mainly in line with minimum protection as stipulated within the aforementioned directives. [...] Consumer Protection is recognised as a specific policy in Iceland. “

Together with the EEA Agreement, we must note that the two EU Directives on unfair contractual terms<sup>65</sup> and commercial practices<sup>66</sup> have been incorporated to the EEA legal order by Decisions of the EEA Joint Committee. The European Recommendation 2001/93/EC (Code of Conduct and pre-contractual information) is also part of the EEA legal order as well as the European Consumer Credit Directive 2008/48/EC (non applicable to house mortgage credit).<sup>67</sup> Substantive law examined *supra* applicable to consumer relations seems to be identical in EU and EEA law. In both legal orders, regarding the protection of consumers in the field of mortgage credit and immovable property the current European legislation allows EU/EEA Member States to allow a higher degree of protection for consumers. There is a diversity of legal regimes in Europe concerning the degree and scope of consumer protection outside the minimum set by the Directives.

Some important general principles of European consumer and contractual law which are part of the EU *acquis* are applicable to the current problems being discussed in Iceland regarding the protection of consumers who contracted both foreign currency mortgages (legal) and Icelandic mortgages linked to foreign currency

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<sup>63</sup> Annex XIX of the EEA Agreement as of 1.5.2010 available at <http://www.efta.int/content/legal-texts/eea/annexes/annex19.pdf>

<sup>64</sup> Information available at the website <http://www.mfa.is/>

<sup>65</sup> Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ No L 95, 21.4.1993, p.29). EEA Joint Committee Decision No. 7/94, OJ [1994] No. L 160, p. 1. Decision available [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21994D0628\(01\):EN:HTML](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:21994D0628(01):EN:HTML)

<sup>66</sup> Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 (OJ L 149, 11.6.2005, p. 22). Decision of the EEA Joint Committee No 93/2006 of 7 July 2006 amending Annex IX (Financial services) and Annex XIX (Consumer protection) to the EEA Agreement, OJ [2006] No. L 289, p. 34. Decision available <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:289:0034:0035:EN:PDF>

<sup>67</sup> Decision of the EEA Joint Committee No 84/2003 (OJ No L 257, 9.10.2003, p. 41) and Decision of the EEA Joint Committee No 16/2009 (OJ No L 73, 19.3.2009, p. 54).

currencies (illegal). The principles of European consumer law explained supra belong to the EEA legal order and have been incorporated to Icelandic law.<sup>68</sup>

There is no specific jurisprudence from the EFTA Court especially relevant to the problem explored in this study but the EFTA Court has already ruled that the protection of the consumers is an integral part of the EEA Agreement.<sup>69</sup> The EFTA Court has declared that it will interpret the internal market legislation in the context of a high consumer protection. As it is the case in EU law, the principle of proportionality is a key issue in determining whether national legislation based on consumer protection breaches or not the EEA internal market legislation. A case-by-case study approach has to be followed as the EFTA Court has ruled.

### 3.1 Application of Directive 93/13/EC in Iceland

Directive 93/13/EC is a part of the EEA Agreement. According to the Icelandic Government, Iceland has transposed Directive 93/12/EC with amendments made to Act No 7/1936, on Contracts, Agency and Void Legal Instruments.<sup>70</sup> The legislation is therefore fully transposed into Icelandic law.<sup>71</sup>

### 3.2 Application of Directive 2005/29/EC in Iceland

Directive 2005/29/EC on unfair commercial practices is a part of the EEA Agreement. Iceland has transposed Directive 2005/29/EC with Act No 57/2005, as amended, on Surveillance of Business Practices and Marketing. The legislation is therefore fully transposed into Icelandic law.<sup>72</sup>

### 3.3 Application of Recommendation 2001/193/EC in Iceland

Regarding the pre-contractual information to be given to consumers by lenders offering home loans, the Commission Recommendation 2001/193/EC has also been incorporated into the EEA Agreement. As Iceland has declared to the European Commission, the Ministry of Trade and Commerce (later the Ministry of Business Affairs and now Ministry of Economic Affairs) introduced these principles to the relevant parties when this Act was incorporated in the EEA Agreement.<sup>73</sup>

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<sup>68</sup> On Icelandic consumer law see Ása Ólafsdóttir and Eiríkur Jónsson, *Staða neytendamála á Íslandi*, Skýrsla Lagastofnunar HÍ, Apríl 2008, 141-240 and *Neytendaréttur*, Codex, Reykjavík, 2009.

<sup>69</sup> In Case E-1/05 EFTA Surveillance Authority v Norway (Case E-1/05 EFTA Surveillance Authority v the Kingdom of Norway, 2005 EFTA Court Report, 234) the Court had to assess the question of whether a requirement in Norwegian law to the effect that costs which accrue when life assurance contracts are entered into have to be charged and paid no later than the date when the first premium payment is due, was in conformity with Article 33 of Directive 2002/83/EC.

<sup>70</sup> A Report from the EFTA Surveillance Authority on the application of the Directive 93/13/EEC in the EFTA countries described the implementation of Directive 93/13/EEC in the Icelandic, Norwegian and Liechtenstein legal orders as it was in 2001. EFTA Surveillance Authority. Report adopted on 6.12.2001 available at <http://www.eftasurv.int/information/reportsdocuments/otherreports/dbaFile5726.pdf>

<sup>71</sup> *Log um sammingsgerð, umbod og ogilda löggæringa (Sammingsalög) nr. 7/1936 breytt með lögum nr. 11/1986 og nr. 14/1995* (Law on Making of Contracts, Agency or Mandate and Void Agreements (Contracts Law) No. 7/1936 as amended by Law No. 11/1986 and No. 14/1995). See <http://eng.efnahagsraduneyti.is/laws-and-regulations//nr/2972>

Note that this is a translation of the original Act that does not include the latest amendments adopted by Act 98/2009 that took effect on 1 January 2010.

<sup>72</sup> We must also take note that Directive 2006/114/EEC on misleading and comparative advertising is a part of the EEA Agreement. Iceland has transposed Directive 2006/114/EEC with Act No 57/2005 on Surveillance of Business Practices and Marketing, with subsequent amendments. The legislation is therefore also fully transposed into Icelandic law.

<sup>73</sup> Reply to the questionnaire sent by Iceland to the European Commission available at the website [http://evropa.utanrikisraduneyti.is/media/esb\\_svor/28%20%20Consumer%20and%20Health%20Protection/Chapter%2028%20-%20final.pdf](http://evropa.utanrikisraduneyti.is/media/esb_svor/28%20%20Consumer%20and%20Health%20Protection/Chapter%2028%20-%20final.pdf)

### 3.4 The role of national judges in the interpretation of credit law related to house mortgages: financial law vs. consumer law?

As the body of general European consumer law is fully applicable in Iceland, one may ask what are the obligations for national judges when applying and interpreting consumer law. National judges must interpret national law as far as possible in the light of EEA law.<sup>74</sup> Their role is essential as the doctrine has already signalled the special context of European contract law where there is a shifting of power from legislators to judges and from a central European level to the national level.<sup>75</sup> In this context, the first reference for Icelandic judges dealing with foreign currency mortgages and/or mortgages linked to foreign currencies should be EU/EEA consumer law which is a strong component of the European legal order and a fundamental policy in the internal market. European consumer law has been incorporated to Iceland. General consumer law cannot therefore be ignored while solving mortgage credit disputes. A misunderstanding must be avoided. The fact that there is no specific European legislation means that the topic or policy remains at national level, not that consumers do not deserve legal protection of their economic interests when contracting house mortgages. The mandate given by European law to protect consumers in the internal market – while ensuring a minimum harmonisation for certain issues - applies both to legislative and judicial powers. While this article focuses on the principles of European law applicable to the solution of disputes currently waiting before the national courts it is obvious that the role of the national legislators is also essential for the amelioration of consumer protection law in Europe.

When disputes arise between banks/financial institutions and consumers, it is consumer law that applies neither financial nor commercial law. According to EU and EEA law, consumers are expected to behave normally and have a standard knowledge of the financial services. Detailed consumer protection and diverse set of legislative instruments have been developed in EU countries in the field of financial services as a certain degree of caution is necessary and a strong consumer protection is advisable. The minimum protection afforded by the European legal order can never be ignored; this would be a violation of the EEA Agreement. Nonwithstanding the different natural provisions of contract law in the EU/EEA Member States in the lack of harmonisation at European level; consumer law and contract law should be applied complementarily. EU-EEA/Icelandic consumer law must deploy all its effects for all cases pending before the courts.

Jurisprudence from the ECJ and the EFTA Court is not directly related to the Icelandic cases of foreign currency mortgages but their case-law confirms that the protection of consumers is essential in the internal market and that that Member States can adopt more protective measures of consumers based on public policy considerations as consumer protection is an essential pillar of economic law and society. In the presence of business-to-consumers transactions, consumer law cannot be pre-empted by financial or business law. While the principle of minimum harmonisation remains the general rule in EU-EEA law, Iceland could even decide to protect consumers with a higher standard. The principle of proportionality is essential to determine how far the national legislation can go to regulate mortgage markets and how consumers are to be protected when contracting house loans.

<sup>74</sup> It is principle both in EEA law and in Icelandic law that national courts must interpret national law as far as possible in the light of EEA law. See EFTA Court, Case E-1/07 *Criminal proceedings against A*, 2007 EFTA Court Report, 245 and M. Elvira Méndez-Pinedo, *EC and EEA Law. A comparative study of the effectiveness of European law*, Europa Law Publishing, 2009. See also Hæstiréttur Íslands. Icelandic Supreme Court judgment in case Nr. 169/1998 *Fagtlán ehf. gegn byggingarnefnd Borgarhóltskóla íslenska ríkinu Reykjavíkurborg og Mosfellsbæ* of 18 November 1999.

<sup>75</sup> Judge Edward, D., "The EC Contract Law Context", in Grundmann, S. And Mazeaud, D. (eds), *General Clauses and Standards in European Contract Law*, Kluwer Law International, 2006, pp. 77-84.

## 4. Conclusions

We can therefore reply to the research questions asked at the beginning of this study in the following way. The protection of consumers with foreign currency mortgages/mortgages linked to foreign currencies in the aftermath of the financial crisis is assured in general by principles harmonised at European level but is properly articulated specifically at a national level. Both general principles and specific national provisions are important and must complement each other.

Consumers in Iceland enjoy protection given by general European consumer law. General principles of European consumer and financial services law are applicable to these contracts and clauses and have been harmonised by Directive 93/13/EC on unfair commercial terms and Directive 2005/29/EC on unfair commercial practices. Recommendation 2001/93/EC on pre-contractual information to be given to consumers by lenders offering home loans is also applicable although non obligatory. This *acquis communautaire* is fully applicable in Iceland.

It is difficult to assess at this stage whether a specific body of European consumer credit law will be specifically adopted in the short-term to deal with financial services and mortgage credits on immovable property in view of the complexities of the area. While a European approach is discussed at EU level, general principles of EU /EEA consumer law and national consumer law remain fully in force and cannot be excluded. Exemptions regarding house mortgage credit must be explicit and interpreted strictly in order not to frustrate the protective ambit of EU consumer law.

National judges have an essential role in the application and interpretation of both European and national consumer law. The consequences of the nullity of illegal price-indexation clauses belong to the sphere of national law and fall mainly on national courts. European rules on consumer protection are mandatory and cannot be waived. The standard of consumer protection given by European legislation is a minimum that can only be ameliorated by EU/EEA Member States. National courts must interpret domestic legislation as far as possible in the light of European law.

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