Loans: general indications

The loan is a contract by means of which one party, known as the lender (usually a bank), transfers a given quantity of money in favour of the other party, known as the borrower, in order for the latter to make use of it for a given time in exchange for payment to the former of a consideration represented by interests.
Having schematised the essential structure and function of the contract in this way, it should straightway be pointed out that a loan in concrete terms is accompanied by various different clauses which cannot always be immediately understood, but which are necessary for regulating all the relations between the parties for the duration foreseen: procedures for delivery of the loan, fixing of the deadlines for repayment of the capital and payment of the interests, determination of other expenses for administrative expenses of the contract, procedure and costs of prepayment, provision and maintenance of guarantees, consequences of defaults which may be either relative (delays) or absolute (non-payment).
Each of these aspects is in turn characterised by all kinds of different possibilities and nuances, as a result both of modern procedures and rules, and of what may quite rightly be defined as an ageold meditation (the loan is contemplated in classic Roman law and was the object of study by Byzantine jurists, by medieval jurists of common law, and by jurists dealing with codifications of modern times). At the present time these themes are further enriched by suggestions and novelties coming from foreign countries and from the discipline of the European Union. All of this gives some idea of the effective complexity of the subject: the loan contract, a typical product of intellectual effort, could be conceived as a composition of juridical engineering, in which the work of construction, dimensioning and co-ordination of the various clauses characterises the result as a whole and contributes to an evaluation in terms of better (or worse) quality and expediency.
Loan contracts are generally drawn up by the banks; if consulted in good time, the civil law notary may exercise some form of control over such contracts aimed at making them clearer and more understandable, at singling out and suggesting solutions better suited to the contracting parties, and at eliminating clauses liable to produce an unjustified contractual imbalance.
If the basic structure of the contract is as indicated, it may and frequently does happen that the loan is stipulated according to a special discipline, that of “land credit”.
Today this discipline is practically indistinguishable from that of an “ordinary” mortgage loan, with discussion, even among the experts, as to whether it is one or the other type; however, certain significant differences exist, some of which will be illustrated in the case files hereafter.
On the other hand what is known as a unilateral loan, quite common in recent procedure, does not constitute a separate case. The difference lies solely in the fact that it only the borrower goes to a civil law notary (an indispensable procedure for the granting of a mortgage guarantee): this way of proceeding may, in fact and according to cases, reduce the civil law notaries role of orientation and consultation.
As from now attention should be drawn to one essential point. Stipulation of the loan does not always signify the immediate material availability of the money: sometimes the banks hold back the sum until they have effectively acquired the mortgage guarantee, in concrete terms (according to the different models), even for a fortnight or more after such stipulation. This point is of considerable importance since, often, the borrower needs to dispose of the money immediately, in order to pay the seller for the house which he contextually grants in guarantee to the bank! One possible solution consists of obtaining from the bank a “bridging” (or “pre-financing”) type of funding,

which covers the period intervening between stipulation and consolidation of the guarantee; but not all banks are willing to offer this solution. With the assistance of the civil law notary , it may be possible, according to cases, to try as far as possible to reach a compromise between the opposite requirements.
Another word of warning concerns one possible aspect: the borrower who knows that the property purchased, on which a mortgage has been taken out, could soon be resold for various reasons (transfer of residence, increase in the size of the family implying the need for a larger house, etc,), sometimes counts on being able to hand over, with relative price variation, to the future purchaser of the property that part of the loan which he still has to pay back: apart from the fact that the purchaser too must agree to such a take-over, and that, at times, the banks may put obstacles in the way of such an operation, it should also be remembered that, as a general rule, such handing over is not "liberatory", but "cumulative": this means that, after the remaining loan has been handed over, the bank does not change its debtor, but rather acquires another one; so that, if the new purchaser by chance finds that he cannot pay the bank, the latter could still advance claims against the original borrower. For reasons like these, presentday procedure in fact makes less recourse to handing over: basically the seller pays off his loan, while the purchaser, if necessary, incurs a new one on his own behalf. On this aspect too, the civil law notary can be of help, illustrating the concrete alternatives available and relative costs.

Duration and amortisation
One of the essential elements in the negotiation of a loan is the respite granted for repayment of the capital loaned, that is the duration. In a general way, it may be stated that the longer duration of a loan implies a lowering in relative terms of the amount of each instalment of its amortisation, giving greater breathing space to the borrower; all of which, however, also implies, overall, the payment of a larger amount of interests precisely because the capital is paid back more slowly. In addition the procedure clearly shows that a longer duration also corresponds to a higher interest rate, to offset what is clearly a greater risk for the bank.
Accordingly repayment of the sum borrowed takes place according to the deadlines laid down by the parties: all of these various agreements constitute the amortisation plan.
Adequate information/knowledge acquired on the amortisation plan is indispensable to the borrower in order to appraise in concrete terms his capacity of fulfilling the conditions, of programming prudentially future financial flows incoming and outgoing from his assets, and of choosing the pattern of repayment most compatible with his own requirements.
Furthermore, in the breakdown of the constituent elements of the instalment (capital and interests), the amortisation plan also serves to pinpoint the financial liability for interests to be shown in a company balance sheet, or the extent to which tax relief could be obtained in the case of loans for the purchase of a first house.
Finally a careful appraisal of the amortisation plan is useful also with a view to possible prepayment of the loan, and likewise payment of any penalty involved: according to the plans agreed on, by halfway through the duration of the loan more or less half of the capital loaned may have been paid back (in loans with "French style" amortisation, this is generally less).
The amortisation plan most widely utilised is that commonly referred to as "French style"; the relative instalments, determined according to a precise and balanced financial formula, consists initially of more interests than capital, while gradually as the procedure comes closer to the deadline, this proportion tends to be reversed.

When the rate of interest chosen is a fixed rate, the amortisation plan determined on stipulation of the contract remains unchanged throughout the contract's duration; whereas if the rate is variable, fluctuations are reflected on the repayment plan itself, so that the amortisation plan illustrated at the time of the stipulation becomes indicative only.
Payment deadlines may likewise be fixed in various ways: thus instalments could be monthly or else three-monthly or six-monthly, etc. The greater the frequency of instalments (for example monthly), the sooner repayment of the capital takes place: this means that, in absolute terms, the borrower will pay less interests. From another point of view, however, since the borrower parts in advance with the money, the actual rate of interest stipulated rises: take for example the following three examples, relative to a scholastic hypothetical loan amounting to 100,000.00 euro for ten years at a nominal rate of 10% (with no other expenses), based on the classic "French style" amortisation:
a) periodicity of annual repayment:
– instalment amount: 16,275.00 euro;
– overall sum to be paid back: 162,750.00 euro;
- amount of interests: 62,750.00 euro;
- TAEG (effective rate): 10%;
b) periodicity of six-monthly repayment:
- instalment amount: 8,024.00 euro;
- overall sum to be paid back: 160,480.00 euro;
- amount of interests: 60,480.00 euro;
- TAEG: 10.25%

c) periodicity of monthly repayment:
- instalment amount: 1,322.00 euro;
- overall sum to be paid back: 158,640.00 euro;
- amount of interests: 58,640.00 euro;
- TAEG: 10.47%.
This gives some idea of the need for the borrower to carefully appraise all the aspects of the contract in order to optimise the prospects of the result achieved.
Recently the financial market has proposed a series of what are called flexible products, in an attempt to meet particular borrower requirements. The following are just a few examples:
a) -what are known as loans with pre-amortisation which give the possibility of taking advantage of an initial period (this may be very brief, in such cases exclusively for technical reasons; or up to a few years) in which the borrower will have to pay only the interest, putting off the start of regular repayment of the capital. As a consequence the first instalments (consisting of interests exclusively) are particularly low, while the later ones (also including capital) are particularly high. Likewise the amount of the absolute cost of the loan is increased as a result of the slowness in repayment of the capital;
b) a variant of the previous type, but having similar effects, is that implying amortisation from the outset, on part of the capital only, postponing to the last payment of a maxi-instalment comprising that part of the capital whose amortisation was put off, and which may vary between a minimum percentage (for example 25%) to a maximum (for example, 50%) of the capital borrowed;
c) finally, the loan in which repayment of the capital is left to the discretion of the borrower apparently implies the utmost elasticity; here the instalments consist exclusively of the quota of interests, while the capital may be paid back freely, usually within the limits of a pre-established grid: for example, 15% by year 5, 20% by year 10, 30% by year 15 and 35% by year 20 (or else: at least 15% by year 7, at least 40% by

year 14 and the remaining 60% by year 20), or similar. Apart from the need for greater planning capacity that such loans imply for the lender, it is clear that while on the one hand there may be a strong temptation to postpone as long as possible repayment of the capital, on the other this implies a cost in terms of payment of the interests which the bank, in view of the freedom granted for return of its capital, is not willingly prepared to forego, as seen from the penalties for prepayment that are usually levied from the borrower who wishes to speed up repayment of the capital.

Interests

The rate of interests is usually expressed as a percentage; this may be fixed, when it is established at the same level for the whole duration of the loan, or else variable, when it is determined with reference to changing parameters established using a criterion of objectivity and impartiality. For example Euribor is an average quotation of variable rates measured using objective criteria on the financial market of the E.U.; while Irs (or *interest rate swap*) is the financial parameter of referenced for establishing the cost of medium and long term operations regulated at a fixed rate. The rate may also be "mixed": which means that at particular points in time, the rate of interest changes from fixed to variable, or vice versa. This, according to the terms of the contract, may occur once or several times in the duration of the loan, and usually depends on a choice to be made by the borrower, giving the required notice.

The choice as between fixed and variable rate is a question of merit, in respect of which the borrower has full discretion and total responsibility: usually the former is preferred by the borrower who thinks that the cost of money will rise in the period of duration of the loan; if this is so, he will have made a good deal, since his instalment will remain unchanged; but if on the other hand the cost of money falls, he could find himself paying a disproportionate interest without having, in contractual terms, any right to bring the bank to modify the conditions of the loan. The variable rate is preferred in particular by the borrower who considers that the cost of money may go down still, and who is anxious not to lose the opportunity of a lower payment instalment as a consequence; if, instead, the cost of money rises, the amount of the instalment will likewise rise. With reference to the same lapse of time, the interest rate on a variable loan is in general lower than one on a fixed rate loan, since in the latter case the bank ensures that it gets a greater remuneration to cover the risk of a future increase in the cost of money and of the consequent loss of the possibility of using money to obtain a higher return.

Particular interests are liable for delayed payment, which are calculated as from the deadline for payment due but not made, until payment actually takes place. These interests on late payment repay the bank for the delay in availability of the money compared to the deadline foreseen, and clearly, worsen the debit position of the borrower.

The rate of interest charged for late payment is generally higher than the ordinary rate, thus discouraging any delay in payments; however, according to the most recent normative and jurisprudential orientations, this cannot exceed certain levels, exceedingly penalising for the borrower. In any case be careful, because in certain contracts, side by side with this interest for delayed payment, fixed in quite congruous terms, you may find other items added in (commissions on unpaid sums, expenses for recovery of credit, etc.) which in concrete terms have the effect of increasing the amount payable by the borrower.

The repetition of delays in payment, or even of definitive failures to pay the agreed instalments, may lead to lapsing of the terms of deferment and to rescission of the contract as a result of absolute default.

Other costs and expenses

Some mention should now be made of the distinction between real rate and nominal rate. The nominal rate (also known in Italy as T.A.N. - Nominal Annual Rate) is the percentage of interests that appears formally fixed in the contract and to which the loan operation is adjusted. In fact, however, the effective cost of the loan is inevitably conditioned by a whole series of other factors: first of all, by various items of expenditure (expenses of investigation, revision and closing; expenses of collection and encashment; costs of mediations carried out by third parties; taxation and insurance expenses; other expenses contractually connected with the transaction); in addition, as seen already, it may be conditioned by the amortisation plan agreed on: instalments which are too close together have the effect of producing a higher actual rate. In relation to such costs, the Italian legislator has elaborated the concept of Global Effective Annual Rate (TAEG), defined as "the total cost of credit payable by the consumer expressed as an annual percentage of the credit granted. The TAEG comprises the interests and all dues to be sustained in order to utilise credit". The norms making it obligatory to indicate the TAEG in contracts and in relative publicity, however only applies to consumer credit, with the explicit exclusion, contained in the norms, of "any financing intended for the purchase or the conservation of a right of ownership over land or a building either built or to be built, or indeed to the carrying out of works of restoration or upgrading": and thereby, in practice it is excluded from mortgage loans.

However, in transposition of the recommendation of the European Commission dated 1 March 2001, most Italian banks have adhered to a "Deontological code for pre-contractual information on loans for the house of residence". On the basis of this code, banks are bound to provide their customers, prior to stipulation of the contract, with a "standardised " informative hand-out (which means that the content and order of the items in the hand-out must be the same for all the banks – throughout the European Community! – thus allowing a better comparison to be made of conditions) in which indication of the TAEG is explicitly required, or, if the amount of the TAEG is not established by the national legislation, as in the case of Italy, the indication of the equivalent effective rate.

So that it is absolutely advisable, in order to take advantage of the criteria of transparency offered by the European Commission, to ask the bank to which the prospective borrower refers if it has adhered to the deontological Code, and in that case, to ask for the informative hand-out. If it has not, only careful and meticulous consideration of all the various items of expenditure will give you a realistic idea of the effective cost of the loan.

Prepayment

In the "land credit" contracts, the possibility of repaying the loan in advance is a faculty attributed by the law to the borrower; but, generally, in contracts of ordinary law this possibility is also conventionally foreseen. Accordingly the borrower may decide, at a certain point in amortisation, to close the contract, by paying back the capital still due, on which of course he/she will cease to pay interests. To offset this loss of profit the bank may, if foreseen in the contract, request some remuneration. According to a resolution of the C.I.C.R. of 9 February 2002, which in fact is only laid down for "land credit" type loans, the remuneration should (if envisaged) be fixed in an "exclusive" and "all-inclusive" way, and the contract should foresee with special and explicit mention, that "no other charge may be debited". What is more: it must specifically

indicate the formula of calculation of such remuneration, utilising, in such case, financial indices available from easily consultable sources, and giving in the contract or some attachment to it one or more examples of application of the formula.
Remuneration for prepayment must be explicitly indicated also in the informative hand-out of the EU.
In a contract for variable rate loan with ordinary amortisation plan, such remuneration, if it exists, is generally fixed at very reasonable percentages.
Whereas the utmost attention should be paid in the case of fixed rate loans, or with particularly flexible amortisation plans: in fact, in such cases the banks are in the habit of accentuating, not always in completely clear terms, the amount of the penalty due on the declared intention of taking up any variations in the cost of money, etc..

Defaulting and guarantees

In order to grant a loan, the bank requires a guarantee: that by far the most frequently used is the mortgage. A mortgage attributes to the bank the right to claim its due from the proceeds of any forced sale of the asset granted in guarantee, with priority over other creditors.
The mortgage is most effective if it is a first mortgage, that is, if it is not preceded by other mortgages: tendentially the mortgage granted to guarantee a "land credit" should be a first mortgage.
A mortgage is taken out on the asset, for an amount in excess of that of the loan, since it has to cover also the interests due, including for delayed payments, and any expenses that the bank may have to incur for recovery of the credit. The amount of the mortgage, equal for example to twice the value of the loan, is however not the final cost of the loan, which is generally lower and may be noted from amortisation plan.
In ordinary circumstances the mortgage lasts twenty years, even if the loan is fixed for a shorter duration than that; once the loan has been repaid, the mortgage becomes formal only, since there is no longer any credit to guarantee: it can be allowed to lapse autonomously, by the passing of time. If, however, the building is to be sold or granted in mortgage to some other bank, it will be necessary to proceed to a specific act of cancellation of the mortgage, which necessarily requires the offices of the civil law notary .
Another possible guarantee to which recourse is frequently had is guaranty, on the strength of which a third person (not the borrower) guarantees generically with his own property fulfilment of the borrower's obligations.
When default by the borrower has become absolute (in the sense that there is no longer merely a delay in payment but a veritable "non-payment" of considerable proportions in the economics of the contract), the bank decides to rescind the contract and to immediately require return of the amount owing to it, without the borrower being able to take advantage of the deferment contained in the amortisation plan.
At this point the time has come to calculate the rescission amount (capital and interests due, interests for delayed payment, and any other expenses): on this amount, if conventionally foreseen, further interests for delay in payment may begin to mature. In the case of non-payment even of the rescission amount, the bank excusses the guarantee, that is, it proceeds to distrain the good and sets in motion the executive process which, with all the guarantees of the law, leads to the sale by auction of the asset itself and to the dividing up of the proceeds between the creditors taking part in the procedure, in conformity with the degrees of legal priority.

Contractual clauses and consumer protection

Law no. 52 of 1996 has introduced into our system rules for the protection of consumers in contractual relations with professionals. In accordance with art. 1469 bis of the Civil Code the physical person acting for purposes extraneous to an entrepreneurial or professional activity carried out is defined as the "consumer"; while the physical or juridical, public or private person who, in the framework of his/her business or professional activity, utilises the contract is the "professional". This relationship is that typically established between the lending bank and the borrower in connection with a house of residence.

It would be too time-consuming to attempt to describe the evolution which, thanks also to other normative provisions, has been recorded in Italy with regard to contracts with consumers; however we have frequently and commonly to note the rebalancing actions of contracts or based on jurisprudence, or as an result of initiatives of consumer associations. Despite all of this, in banking contracts we still find clauses at the very least "suggestive" of illegality, which for various reasons have still not been eliminated.

From the point of view of the rules governing this relationship, strong suspicions of illegality tend to be aroused, for example by clauses:

1) which establish as the exclusive forum competent to settle any disputes, the place where the head offices of the bank and not the consumer's residence are sited;
2) on the basis of which the statements of account of the bank in question always constitute full proof against the borrower party;
3) that unconditionally inhibit the borrower's right to ask request cancellation of the mortgage guarantee once the loan has been fully repaid;
4) that prohibit in absolute terms the handing over of the debt deriving from the loan;
5) whereby use of the property as guarantee is largely inhibited;
6) which depart from the regime of partiality and subsidiarity foreseen in the field of obligations arising from the discipline of legal communion between spouses;
7) which empower the bank to rescind the contract in case of failure to respect too generic or not particularly meaningful obligations, or not corresponding to interests which deserve to be protected;
8) which transfer to the borrower direct taxation liabilities of the bank.

From the point of view of the economics of the relationship, other clauses which appear illegal are those which aim at allowing the bank to modify unilaterally and without good reason the economic conditions of the contract, including the rate of interest. In fact it is quite clear that the customer incurring a loan relies fully on the rate and duration agreed on, and accepted by him/her on the basis of the income which he/she expects will enable regular fulfilment . The customer may (and should) decide as between a variable rate and a fixed rate: he/she is the only judge of such a choice and fully responsible for it. Whereas it would not seem compatible with the nature of the contract that such elements may be modified unilaterally and discretionally by the bank, for example, by raising the amount of the fixed rate, or the reference parameter of the variable rate, or the percentage increase of the latter (the so-called **spread**), or that it obliges the borrower, if unwilling to agree to such modifications, to terminate the relationship in advance.

The role of the civil law notary

Loans for the house of residence are generally guaranteed by a mortgage and are therefore reserved, in our system, as in most European countries, to the necessary competence of a civil law notary .

The presence of civil law notaries has become even more evident on account of the recent considerable increase in the number of such contracts, due to the lowering of financial interest rates and the improvement in living conditions, thus enabling a growing number of citizens to have access to **ownership of the house in which they**

live, and often also of a second house. For years now, and year by year, the daily press has given rightful prominence to the continuing rise in the number of property loans stipulated: a trend which, at least in the short term, appears to be consolidating. To this should be added the growing commercial thrust aimed at an ever more intense, and perhaps not sufficiently meditated, use of financial products (reference could be made, in the context of the EU, to Resolution of the Council of 26 November 2001, which expressing concern at an excessive endebtedness of consumers, proposes preventive measures in the form of information for debtors, the responsibility of those offering credit, indemnities and expenses in the case of non-performance of the contract, and the role of credit intermediaries and agencies).

The privileged observation point of civil law notaries has induced the latter to assume various initiatives relative to loans; initiatives addressed to the world of consumers (and their Associations), of the weakest social groupings and above all of families: fundamental sectors, which are governed by specific norms which must be taken into account;

to the banks, whose function has a social importance that is universally recognised, and whose collaboration is necessary for the task of improvement which it is hoped to achieve: the contributions of the banks is fundamental for a better understanding of the problems and their most correct solution;

to the academic sector of studies and universities, which constitute a primary reference for a correct scientific approach to these questions.

In an attempt to synthesise the varying interests implied by the above-mentioned categories, notaries have the institutional task of guaranteeing, on the one hand, observance of the legislative norms and, thereby, the validity and efficacy of contracts, also thanks to the systematic adoption of new products that operative practice constantly proposes; and on the other, to ensure in concrete terms a suitable contractual balance for both parties. This has been done, first and foremost, by the promotion of various initiatives of study and comparison, aimed at analysing and correctly examining topics and material fostered directly by practice, very often on the basis of debate between the parties concerned (consumers' associations and ABI – Italian Banking Association) and with the scientific supervision and in-depth investigation of university experts.

All of this work, together, of course with the introduction of norms to substantially protect consumers and borrowers, with the evolution of a social and economic awareness due also to the initiatives of ABI and of the consumers' associations, as well as the recent crises in the sector of mortgage loans (to which attention has been widely drawn by the mass media), have led to a change in trend: contractual texts, albeit progressively and, at times, unfortunately with unexpected backsliding, are improving, thanks among other things to the perseverance of initiatives carried out by civil law notaries, both individually and collectively. More and more frequently banks now follow the suggestions made by the civil law notaries required by their customers to receive the funding acts; take the case in which contractual texts prepared for mass use, have been drawn up or modified with the contribution of civil law notaries. Where the role of the civil law notary works best, it becomes customary to refer to the latter even prior to choosing the bank, for the purpose of obtaining advice and useful suggestions: on such occasion the civil law notary , on account also of the prestige and competence he now enjoys, can offer the benefit of his/her own experience, he/she can also help pinpoint which banks have effectively adhered to the deontological Code promoted by the EU Commission. The practice of referring in good time to the civil law notary is all-important and to be encouraged, since the civil law notary can do much less if the problems are only raised immediately prior to contractual deadlines, when the

purchaser of the property, in order to meet the commitments assumed, absolutely needs to arrive somehow or other at delivery of the funding. In order for the best operative practices to become more homogeneous over the whole of the national territory, it is important for the habit of referring in good time to the civil law notary to spread among those negotiating mortgage loans.
These tasks, which could be defined as legal advice, should be added to those more traditionally ascribed to civil law notaries: preliminary inquiries (the so-called "title searches", regarding mortgages and the land register), the legal report for the bank, the drafting and stipulation of the act, all of the various subsequent procedures (tax registration, entering of the mortgage, issuing of executive and other copies), etc. Moreover to consultation on civil matters should be added consultation on taxation aspects. The loan incurred with a bank for a duration of over eighteen months benefits from considerable tax concessions as regards indirect taxes: the contract is not liable to stamp tax, nor registration fee, nor tax on mortgage registration, but exclusively a substitutive tax of 0.25% on the amount of the loan, which is withheld directly by the bank and paid over to the Inland Revenue. However the loan on the first house of residence also qualifies for a saving in direct taxation: in fact it is possible, in the borrower's income tax returns, to deduct the interests and expenses of the contract, up to a certain limit and on given conditions: on this aspect too the civil law notary is best placed to provide indications for the correct assessment of the taxation impact of the operation, with a view to using the various possibilities to best advantage.

(from http://www.notariato.it/eng/home.aspx).