

Economic Analysis of the Rechargeable Mortgage System

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Abstract: The rechargeable mortgage system, created by French security law reform in 2006, maintains the value of safety of the traditional general mortgage system and strengthens further the superiority of mortgage system, by simplifying it's procedures of the constitution and realization, reduces the cost of security and other measures. It not only conforms to the economic rules of Pareto efficiency and Karldor-Hicks principle, but also reflects the pursuit of French security law reform for the value of liberty, efficiency and balance of interests. Considered as one of the most significant and dazzling outcomes of the reform in 2006, it is thereafter admitted and enhanced in 2009 by the trust-guarantees (transfer-property guarantee) system.

1. Introduction

According to Article 2422 of the French Civil Code, the rechargeable mortgage is a mortgage which may later be assigned to guarantee the debt(s) other than those designated by the initial contract. Widely considered as the "most brilliant and important system innovation of the security law reform on 23 March 2006",[1] it aims to stimulate the mortgage financing by lowering the operational cost and to improve the economic efficiency of the mortgage system.[2]

2. The Mechanism of the Rechargeable Mortgage

2.1 The Conditions of the Formation and Countermineness Effectiveness

The establishment the rechargeable mortgage subjects to certain conditions. Its essential mechanism contains two contracts: the initial mortgage contract, also known as the charged contract, and the recharged contract.

Firstly, the initial mortgage contract must contain a clause expressly stipulating that it creates a rechargeable mortgage which may later be assigned to guarantee the debt(s) other than those designated by the initial contract. It must be published in the mortgage register for obtaining the countermineness effectiveness against third parties (art. 2428, para. 4, C. civ.). The conditions of validity are the same as regular conventional mortgage, except that the debts secured by the rechargeable mortgage are not determined by the initial contract, the debts secured could be an un-known, undetermined or indeterminable debts at the moment of the establishment the rechargeable mortgage. This turns it as an exception of the principles of specialty and subordination on real rights for security. But the maximum amount guaranteed by it should expressly be determined in the contract, otherwise it is invalid.

Secondly, the mortgagor may use this mortgage for guaranteeing new debt(s) to the initial creditor or other creditors. The amount of the new debt(s) cannot exceed the available credit line which equals the difference between the maximum amount and the unpaid debts previously guaranteed.

In practice, imagine that there is a building having a value of 1 million and it's owner sets a rechargeable mortgage on this building with the maximum amount of 0.7 million and an initial debt guaranteed of 0.5 million. Under this circumstances, even the initial debt guaranteed remains unpaid, the subsequent creditor(s) guaranteed by the following recharged mortgage can still receive 0.2

million. Conversely, if the maximum amount can not exceed the amount of the initial debt, the effectiveness of the recharged mortgage shall completely depend on the payment situation of the initial. The subsequent creditor would receive nothing in the event of non-payment of the initial. In this case, the rechargeable mortgage system would be a vain system. Therefore, the maximum amount of the rechargeable mortgage can exceed, and normally shall exceed the amount of the initial debt.

Like the initial mortgage, the recharged mortgage shall also be notarized, otherwise it is invalid. It shall also be published in the mortgage register by making marginal reference beside the initial registration for obtaining the countertermine effectiveness against third parties (art. 2430, para. 3, C. civ.). This publicity allows the creditor(s) guaranteed by the recharged mortgage(s) to retroactively claims his(theirs) priority of payment on the date of the initial mortgage against third parties. Among the the creditor(s) guaranteed by the initial mortgage and recharged mortgages(s), the publishing order determines their priority rank. Imagine that there is a rechargeable mortgage, Party A is the creditor guaranteed by the initial mortgage registered on January 1st, and Party B is the creditor guaranteed by a normal regular mortgage registered on February 1st, and Party C is a creditor guaranteed by a recharged mortgage registered on March 1st, if these 3 creditors are not paid at the expiration of the term, the payment priority among them would be A, C and finally B.

2.2 The Scope of Application

The rechargeable mortgage is an open system available for all, individual or corporation, consumer or professional, provided that he has the capacity for behavior and has the right of disposition of the mortgaged asset.

However, in consideration of consumer protection, the Consumer Code imposes a formalism requirements for the rechargeable mortgage in the field of consumption. The supplier of consumption credit must prepare an attached document which is named as “mortgage situation” and contains certain statutory items, otherwise he shall lose his right to claim the interest and shall be punished by a fine of 3750 euros (art. L.313-14-1 and L.313-14-2, C. Cons.). In addition, the rechargeable mortgage in the field of consumption can not guarantee revolving consumer credit (art. L.313-14, C Cons.) by which the supplier of consumption credit awards a credit line to consumer for a period, within the line and this period, the consumer can recycle the credit loan for consumption.

2.3 The Extinction

The extinction of the rechargeable mortgage also reflects it’s particularity.

On the one hand, the rechargeable mortgage will not extinct along with the extinction of one debt or some debts it guaranteed. Regardless of the extinction of the debt(s) guaranteed, it, as a whole right, remains available in the hands of the mortgagor by which he may use it for guaranteeing new debt(s). This constitutes an exception of the principles of subordination of the real rights for security (art. 2422, C. civ.).

On the other hand, it will not be extincted if the creditor(s) guaranteed waives his right (art. 2488, 2o C. civ.). But it will be extincted if the debtor waives his right of the existence of the rechargeable mortgage. In such case, it is effective only for the future and has no retro-activity in regard to the debt(s) guaranteed already registered before waiver (art. 2423, para. 3, C. civ.). At the moment of the waiver, if all debts guaranteed have totally been paid-up, the mortgagor is entitled to claim the radiation of the rechargeable mortgage; if all debts guaranteed haven’t been paid-up, the mortgagor needs to record in the mortgage register by making marginal reference that the mortgage is no longer rechargeable therefrom.

2.4 References for Perfecting the Transferring Guarantee System

The useful experience of the rechargeable mortgage system has been introduced to the system of transferring guarantee by a law reform in 2009 and has been codified into the French Civil Code. From then on, the guarantor of a transferring guarantee can create a rechargeable transferring guarantee by stipulating expressly in the initial guarantee contract that the guarantee is rechargeable,

no matter the property is movable or immovable (Art.2372-5 and Art.2488-5, C. civ.). That means the guarantor of a transferring guarantee may later use the same real right for security for guaranteeing the debt(s) other than those designated by the initial contract.

This introduction undoubtedly reduces the costs of time and money of using the transferring guarantee system, promotes the application of such guarantee system in credit practice, as well as further stimulates the smooth development of credit transaction.

3. Analysis of the Rechargeable Mortgage System According to Several Economic Schools

3.1 The Creation of the Rechargeable Mortgage System Increases the Institutional Supply, Which Conforms to the Kernel Theory of Neo-Institutional School and New Supply-side School

The creation of rechargeable mortgage system in French security law reform in 2006 has been influenced by the theories of neo-institutional school and the new supply-side school, which have been developed and perfected in 20th century.

According to neo-institutional school, an institution can be treated as a public good produced by an individual or an organization, i.e. the institutional supply. However, the institutional supply is always of limit and scarcity, due to the bounded rationality of human being and the scarcity of resources. With the changes of external environment or the improvements of the rationality of human being, human society will constantly put forward new demands of new institution/system for responding to the changes or improvements, and increasing expected benefits. When institutional supply and institutional demand are basically balanced, the system is stable. When the existing institutional supplies cannot meet the demands, institutional change will occurs.[3]

New supply-side school considers that the government should remove all the constrained factors of supply left by Keynesian intervention and planned economy before gradually withdrawing from the market. The government plays an important role in removing constrained factors of supply and liberating productivity forces, provided that the intervention of the government shall be subject to strict and transparent institutional constraints. [4]

These two theories have deeply influenced the system design of French security law reform in 2006. In the context, the reform designers aim to guarantee the free will and free choices of transaction parties: transaction parties can freely choose to create mortgage on movable or immovable property, freely determine the maximum amount of mortgage, freely choose to register the mortgage or not. Meanwhile, they put the mortgage system under the strict and transparent institutional constraints: the legal text stipulate expressly that the publicity in the mortgage register (i.e. registration) is the condition for obtaining the countermine effectiveness against third parties. Therefore, the reform designers realize the purposes of further enhancing the credit value of mortgage asset, improving financing efficiency and possibilities by creating the rechargeable mortgage.

By example, Party A is the creditor guaranteed by the initial mortgage registered on January 1st, and Party B is the creditor guaranteed by a normal regular mortgage registered on February 1st, and Party C is a creditor guaranteed by a recharged mortgage registered on March 1st. If these 3 creditors are not paid at the expiration of the term, the payment priority among them would be A, C and finally B. In practice, as a rational person, Party B would not choose to be guaranteed by creating a regular mortgage if he knows the existence of the rechargeable mortgage. According to the payment priority rules above mentioned, the priority rank of the new regular mortgage is after the rechargeable mortgage. It makes sense only if the amount of Party B's credit exceeds the available credit line contained in the rechargeable mortgage (i.e. the difference between the maximum amount and the unpaid debts previously guaranteed), and the real value of the mortgage asset exceeds the maximum amount of the rechargeable mortgage. Therefore, the best choice for Party B is to conclude a recharged mortgage contract with the mortgagor and publish it in the mortgage register on the one hand; on the other hand, to establish a regular mortgage contract with the mortgagor and publish it in the mortgage register.

From this perspective, the creation of the rechargeable mortgage system not only increases an institutional supply for mortgagor(s) and creditor(s), but also enhance the protection for both mortgagor(s) and creditor(s).

3.2 The Creation of the Rechargeable Mortgage System Conforms to the Evaluation Criterion of Pareto Improvement

According to the rules of the rechargeable mortgage system, the mortgagor may fix a maximum amount which can exceed the amount of the initial debt guaranteed. This system provides more choices and possibilities for financing needs, and obviously improves the utilization efficiency of the mortgage assets. It conforms to the criterion of Pareto improvement from the perspective of economics, i.e. it can makes some gain more benefits without reducing anyone's benefits or making anyone in a worse situation.[5] In details, in the framework of rechargeable mortgage system, as long as the initial mortgage completed the legal procedure of publicity (registration) in the mortgage register, it obtains the countertermine effectiveness against third parties and subsequent creditor(s) guaranteed by recharged mortgage(s).

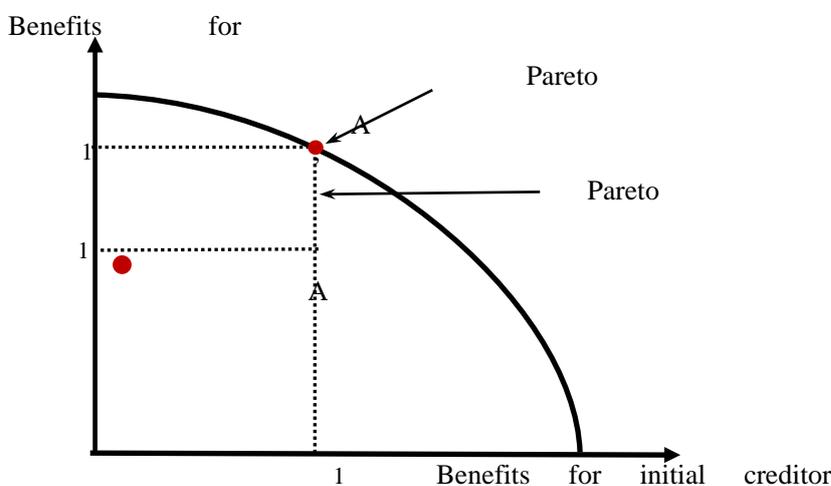


Fig.1 The Influences of the Rechargeable Mortgage between the Parties is as Shown Above: It Will Cause Point a to Move Towards Point A'.

For initial creditor guaranteed, he will not be negatively influenced by the following mortgages, no matter it is recharged mortgage(s) or regular mortgage(s).

For mortgagor, the most outstanding advantage of the rechargeable mortgage is that it can be assigned to guarantee the debt(s) other than those designated by the initial contract, in the limit of the maximum amount. The mortgagor may use this mortgage for guaranteeing new creditor(s), either initial creditor or others, even the initial remains unpaid. One evaluation of the mortgage asset, several utilization of mortgage on the same asset. It obviously increases benefits for mortgagor by simplifying the legal procedure(s) of the following mortgage(s), reducing the cost of time and the cost of money (by comparing with regular mortgage, the mortgagor has no need to reappraise the mortgage asset and so he can save about 1%~1.3% of the value of mortgage asset as to evaluation fee; as to the real estate registration tax, save about 0.7% of the value of mortgaged asset).[6] Besides, it provides more opportunities for the mortgagor to seek financing and increases potential outputs of the same asset.

For subsequent creditor(s) guaranteed, the publicity in the mortgage register by making marginal reference beside the initial registration allows him(them) to have the entire countertermine effectiveness against third parties, and retroactively claim his(theirs) payment priority on the date of the initial mortgage against third parties. His rights based on the mortgage just have the "possibility" to be realized. Given that the mortgagor has no other asset to mortgage, this "possibility" will not reduce his any benefit or make him in a worse circumstances than that without this "possibility".

Therefore, the rechargeable mortgage system obviously improves the utilization efficiency of the

mortgage assets.

3.3 The Creation of the Rechargeable Mortgage System Conforms to Kaldor-Hicks Principle and Enhances the Balance of Interests between the Parties

In terms of the balance of interests of between the mortgagee creditor(s) and the mortgagor, the traditional mortgage system generally grants the creditor(s) the rights of payment priority, pursuing effect, and preservation of mortgage. It favors protecting the interests of the mortgagee creditor(s) and relatively ignores the interests or needs of the mortgagor. However, the rechargeable mortgage system simplifies the operational procedures and reduces the costs of money and time that the mortgagor needs to bear, so it is quite beneficial to the mortgagor. From a certain point of view, the most obvious and important advantage of the rechargeable mortgage system is for the mortgagor rather than the mortgagee creditor(s). Therefore, this innovative mortgage system enhances the balance between the interests of the mortgagee creditor(s) and the interests of the mortgagor.

However, if we take into account the factors of notaries and the government, and considers them as interested parties of this institutional reform, we may conclude that the creation of the rechargeable mortgage system does not meet the criterion of Pareto improvement because the interests of the interested parties are damaged. In this case, it is necessary to analyze this institutional reform with the help of another important criterion of welfare economics: the criterion of Kaldor-Hicks efficiency. Under the Kaldor-Hicks efficiency test, an outcome is efficient if those who are made better off could in theory compensate those who are made worse off and so produce a Pareto efficient outcome. Although all Kaldor-Hicks efficient situations are Pareto optimal, in that no further Pareto improvements can be made, the reverse is not true. Conversely, although every Pareto improvement is a Kaldor-Hicks improvement, most Kaldor-Hicks improvements are not Pareto improvements.[7]

In France, the evaluation of the real estate is normally executed by notaries whose remuneration generally equals 1.0%~1.5% of the value of the real estate. By creation of the rechargeable mortgage system, it seems that it will reduce the remuneration of the notaries because this system allows the mortgagor to repeatedly use the same real estate for guaranteeing several debts by only one evaluation. However, statistics from French National Union of Certification Associations show that the average income of French notaries hasn't been decreased after the creation of the rechargeable mortgage system from 2007 to 2016, but increased substantially.[8] One important reason is that the creation of the rechargeable mortgage system reduces the remuneration of the notaries in a single rechargeable transaction, but generally it is possible to be compensated by the increase of total income caused by considerable increment of mortgage transactions stimulated by this new system and the go-up of real estates (in fact, as long as there is no go-down of the value of real estates, the result remains the same). So French notaries are made better off rather than worse off.

The utilization of the rechargeable mortgage system allows the mortgagor to pay less real estate registration tax which equals about 0.7% of the value of the mortgaged real estate. It seem that it will reduce the relative tax income of the government. But in practice, the reduction of tax income is fully compensated and has a surplus for the same reason above mentioned.

Therefore, the interests of notaries and government will be damaged from the perspective of a single rechargeable mortgage transaction, but the relative damages could be compensated by the considerable increment of transactions stimulated by the creation of this new system in general. The creation of the rechargeable mortgage is a Kaldor-Hicks improvement.

In conclusion, the creation of the rechargeable mortgage in French security law reform in 2006, maintains the value of safety of the traditional general mortgage system and strengthens further the superiority of mortgage system by better reflecting the pursuit of the value of liberty, efficiency and balance of interests between the parties.

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