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Newsletter

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REAL ESTATE

The Register Mortgage Certificate

Since January 1st 2012 the revised law of real property has been in force. As a central innovation, the register mortgage certificate was introduced. Already within this short period of time the register mortgage certificate has turned out to be a legal success story, making it worthwhile to take a closer look at this new instrument.

1 THE MORTGAGE CERTIFICATE IN GENERAL

The mortgage certificate establishes an abstract claim ("certificate claim"). In order to secure the certificate claim, an individualized property is pledged. The bank's claim related to the loan ("loan claim") will be secured through a **pledge over or security transfer** of the certificate claim. In practice the predominant version is the security transfer of the certificate claim because this will spare the creditor the intermediate step of acquiring full title to such certificate claim. Thus, there are **two claims coexisting**. If the loan claim is not paid, the certificate claim can be asserted. If such certificate claim is not paid, the pledged property can be enforced. If the property is realized, the proceeds will be used to repay the certificate claim. Based on the security agreement between the creditor and debtor, the amount of payment of the certificate claim will be offset against the loan claim.

A mortgage certificate can be issued in **paperless form or as bearer or nominal mortgage certificate**. The mortgage certificate, in particular the certificate claim, must be distinguished from the **mortgage**. The latter, like the register mortgage certificate, will not be issued in paper form but only registered in the land register. Other than the register mortgage certificate, the mortgage does not constitute an individual abstract claim. Instead, in case of a mortgage the loan is directly secured with the pledge over the property. Compared to mortgage certificates, the transfer of the mortgage is only possible by maintaining and transferring (possibly re-negotiating) the original loan.

2 ESTABLISHMENT

The establishment of a register mortgage certificate requires a **public notarization of the granting of the certificate claim and the pledge relating to the respective**

property. This is also the case with respect to an owner register mortgage certificate if the owner establishes a mortgage certificate in their favor and to their charge (they become, therefore, both creditor and debtor of the certificate claim). The owner register mortgage certificate can be kept in reserve in order to enable a future financing quickly and without any notarizing. The register mortgage certificate only comes into existence upon the **registration of the publicly notarized act of establishment in the land register.** As opposed to the bearer or nominal mortgage certificate, the register mortgage certificate is not physically issued on paper. The register mortgage certificate is freely transferable. The creditor of the certificate claim is in principle the person registered in the land register. Due to the requirement of registration, a register mortgage certificate can only be issued in the name of a person. A bearer register mortgage certificate is logically impossible. Hence, a creditor can only remain anonymous in the land register and to third persons if a bearer or a nominal mortgage certificate (endorsed in blank) is established.

"The register mortgage certificate only comes into existence upon the registration of the publicly notarized act of establishment in the land register."

The **fees** for the notarization and registration of the register mortgage certificate vary depending on the respective canton. Such fees typically correspond with the costs for the establishment of paper mortgage certificates and can be substantial. For example in the canton of Zurich the notarization fee amounts to 0.1% and the land register fee to 0.15% of the certificate claim.

For paper mortgage certificates there is the option of registration in the **creditor register.** This registration must not be confused with the registration of a creditor of a register certificate claim. The registration in the creditor register will cause the land register to send notifications to the registered persons, but is no evidence for the fact that the registered person is the creditor of the certificate claim. In fact, people often forget to inform the land register of the creditor change to be noted in the creditor register. The registration in the creditor register is voluntary.

3 CONVERSION

In order to support the popularization of the register mortgage certificate, the **conversion** of paper mortgage certificates was facilitated provided that they were established before the introduction of the register mortgage certificate. The property owner and the mortgage certificate owner can **jointly request a conversion in writing.** A notarization of the conversion or legalization of signatures is not necessary. The conversion of paper mortgage certificates established after the entry into force of the new provisions must be notarized. Usually **fees are low** for the notarization of a conversion. The fees for the registration in the land register typically range between CHF 50 and 200 per mortgage certificate (excluding the canton of Geneva where fees are substantially higher).

4 CHANGE OF CREDITOR

The change of creditor of a register mortgage certificate occurs by transfer of the register mortgage certificate from the old creditor to the new creditor. The transfer requires both an undertaking to transfer and a title transfer. The **undertaking to transfer** (contractual obligation that the old creditor shall transfer the mortgage certificate) requires no particular form. The **title transfer** (perfection of the undertaking to transfer, i.e. transfer of the mortgage certificate) occurs by **registration of the new creditor in the land register** based on a **written declaration of the prior creditor.** There is no need for legalization of signatures.

The registration of the new creditor is mandatory. The **transfer is effective** at the time the application to the land register is made. The land register must immediately register the application in the journal. However, the land register may verify the application within an appropriate period. If there are no reasons opposing a registration, the transfer will be registered in the main register with the date the journal entry was made. The transfer is perfected only upon entry in the main book. For such registration only a small fee is charged (usually less than CHF 100). The fee is thus minimal but compared to the transfer of a paper mortgage certificate not free.

According to the predominant legal doctrine, the transfer of the register mortgage certificate depends on the validity of the undertaking to transfer. If it is invalid, a retransfer is required. However, **the good faith of an acquirer** of a register mortgage certificate from a registered but unauthorized creditor will be protected. In such case, no retransfer will be made.

"Therefore an important advantage of the register mortgage certificate is that the debtor can identify the creditor by checking the land register, even if the mortgage certificate was sold without the debtor's knowledge."

The debtor must pay the person registered as creditor in the land register at the time of the payment. The transfer of the mortgage, however, **does not require a notification to the debtor.** Therefore an important advantage of the register mortgage certificate is that the debtor can identify the creditor by checking the land register, even if the mortgage certificate was sold without the debtor's knowledge. The debtor cannot argue that he did not know about the entry in the land register. If they pay without knowledge of the entry, it is done at their own risk.

The majority of register mortgage certificates are held by banks. In order to facilitate the administration of register mortgage certificates, SIX SIS AG offers its accredited credit institutes a **fiduciary management of register mortgage certificates.** Thereby, the register mortgage certificate will be registered in the name of SIX SIS AG. In case of a creditor change, no modification of the entry will be made. However, the trustee now holds the register mortgage certificate on behalf of the new creditor. The application with the land register and the **registration of**

the transfer to the new beneficial owner are therefore not necessary. The future will show if the split between loan creditor and certificate creditor causes any difficulties. For example, issues could arise if the nominal value of the register mortgage certificate is increased. Correctly, the nominal value of the register certificate would have to be increased in favor of SIX SIS AG with whom the mortgage debtor has no credit and security agreement.

"With any form of mortgage certificate there are consequences if, due to a creditor change, the loan creditor is not identical to the certificate creditor."

With any form of mortgage certificate there are consequences if, **due to a creditor change, the loan creditor is not identical to the certificate creditor**. If for example the loan creditor sells the mortgage certificate, the new certificate creditor may, if acting in good faith, claim the full amount of the certificate claim. The prior creditor must deduct the proceeds of the mortgage certificate sale from the loan claim. Such creditor remains an unsecured creditor for the remainder of the process. Damage claims of the debtor due to violations of duties of the creditor concerning the realization are reserved. Accordingly, the debtor may owe more than 100% of the loan claim. If, for example, a mortgage certificate with a value of 100 is sold at 20 and the loan claim amounts to 100, after the sale the debtor owes 80 to the loan creditor and 100 to the mortgage certificate creditor; i.e. 180 in total (compared to 100 prior to the sale). In case of a **pledge** over the mortgage certificate, this issue is resolved in Art. 156 para 2 of the Swiss Debt Enforcement and Bankruptcy Act (DEBA) by reducing the mortgage certificate to the amount of realization (20 in the example so that the total debt remains 100). This solution does not apply with respect to the usual **security registration** (wherein the loan creditor becomes creditor of the certificate claim with full title). The pledge of a register mortgage certificate **is the exception**. Accordingly, with respect to the security registration the abovementioned risk remains, unless an analogous application of Art. 156 para 2 DEBA is contracted for (which rarely occurs) or if the creditor only transfers the mortgage certificate together with the loan claim (including security agreement).

5 CHANGE OF DEBTOR

Contrary to a widely-held belief, the respective owner of the property subject to the security is not automatically the **debtor of the certificate claim**. Because of the abstract nature of the mortgage certificate, the mortgage certificate debtor will, absent an explicit agreement, remain the same upon a sale of the property (even if the loan claim is transferred to the new property owner). In this case the creditor has a double security: On the one hand they can assert the certificate claim towards the prior mortgage certificate debtor and on the other hand hold the new owner liable as third-party pledgor. Pursuant to Art. 832 para 2 of the Swiss Civil Code (CC), the prior mortgage certificate debtor will be released unless the **mortgage certificate creditor declares in writing within one year** after the notification of the debtor change by the land register that the former debtor shall remain in place. The

benefit of this provision is, however, limited. First, the creditor has no reason to approve the debtor change, i.e. to release the prior debtor. Second, a debtor change only occurs if the new debtor (property owner) undertakes to assume the certificate claim (which usually will not be explicitly agreed upon). It is not mandatory to register the debtor of a register mortgage certificate or a paper mortgage certificate. Such registration of the debtor is not a problem as long as the property owner and the debtor are the same person, i.e. as it is the case at the time of the establishment of the mortgage certificate.

"Contrary to a widely-held belief the respective owner of the property subject to the security is not automatically the debtor of the certificate claim."

If there is no entry of the debtor, the land registry office cannot notify the debtor if a creditor change occurs. This increases the risk that the debtor pays to the wrong creditor so the claim against the debtor will not be discharged. However, with the register mortgage certificate this risk is very limited because the debtor can identify the creditor based on the land register. The registration does not create any good faith concerning the person of the debtor. However, **if there is a registration** it should be ensured upon a sale of the property that the registered debtor is changed, which is often missed and (depending on the canton) not done by all the land registry offices. Thus, even if the parties agree to a transfer of the certificate claim, in case of a registration there remains uncertainty with respect to the person of the debtor. If there is no registration, at least a wrong appearance can be avoided. From the debtor's point of view it seems after all to be **advisable not to register the debtor of the register mortgage certificate in the land register**.

6 ANALYSIS

Besides the advantages already mentioned, the register mortgage certificate has **further benefits**. As it is not issued in paper form but only registered in the register, it does not need to be expensively stored and transferred. Furthermore, a register mortgage certificate cannot be lost. Upon loss of a paper mortgage certificate, such certificate must be invalidated by means of a costly and lengthy cancellation procedure. This cannot happen with a register mortgage certificate. Nominal mortgage certificates are transferred through endorsements (assignment declarations on the mortgage certificate). In the course of these endorsements, mistakes often occur which are difficult to correct. With a register mortgage certificate these mistakes cannot happen. Finally, a register mortgage certificate will ensure that the land registry offices will only notify the effective creditor.

Based on a non-representative survey among notaries in Zurich, it has been estimated that at least in the canton of Zurich **95% of the newly established mortgage certificates are register mortgage certificates**. Conversely, due to excessive land registry fees, almost no register mortgage certificates have been established in the canton of Geneva to date. Based on the experience in the canton of Zurich, it can be estimated that just three years after its introduction

the register mortgage certificate has nearly replaced the paper mortgage certificate with respect to the establishment of new mortgage certificates in most of the cantons.

In particular bigger banks almost exclusively establish register mortgage certificates which then are fiduciarily

transferred to SIX SIS AG. The **conversion of paper mortgage certificates into register mortgage certificates** seems to be very limited so far. Due to the clear advantages of the register mortgage certificate as well as limited effort and low costs, owners of paper mortgage certificates (except in the canton of Geneva) should pro-actively initiate the conversion as soon as possible.

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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:

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