REGULATION OF MORTGAGE BANKS AND MORTGAGE BONDS IN POLAND:

ASSESSMENT OF THE REGULATORY FRAMEWORK FOR MORTGAGE BANKING IN EUROPEAN UNION COUNTRIES WITH LESSONS LEARNED FOR POLAND

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Prepared by

Loïc Chiquier

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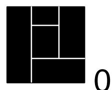
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THE URBAN INSTITUTE
2100 M Street, NW
Washington, DC 20037
(202) 833-7200
www.urban.org

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TABLE OF CONTENTS

ABSTRACT i

LIST OF ACRONYMS ii

1. INTRODUCTION 1

2. EUROPEAN UNION DIRECTIVES ON MORTGAGE BONDS 2
   Mortgage Bonds 2
   Specialization of Mortgage Banks 3
   Other European Union Directives 4
   Other Regulations for the Banking Investors of Mortgage Bonds 5

3. EU DIRECTIVES ON RISK WEIGHTING 6

4. EUROPEAN LOAN TO VALUE STANDARDS FOR MORTGAGE LOANS 13
   A. Variable LTV Ceilings 13
   B. Standard LTV Ceilings 15

5. ISSUES RELATED TO THE MATCHING OF ASSETS AND LIABILITIES 16

6 VALUATION STANDARDS APPLIED TO MORTGAGE BANKS 23

7. OTHER INDIRECT REGULATORY ISSUES 28

APPENDIX

ABSTRACT

This paper offers an analysis of regulatory issues introduced by Poland s Act on Mortgage Banks, focusing on European Union countries experience in the regulation of mortgage banks and mortgage bonds and the implications of the different rationales underlying regulation for decisions which must be made in Poland. It also includes an analysis of a major report prepared by the Foundation for Mortgage Credit, Development of Terms and Conditions Concerning Implementation of the Act on Mortgage Bonds and Mortgage Banks of 29 August, 1997." Recommendations are made for the Polish environment based on an analysis of EU rules and regulations, particularly of risk-weighting rules and valuation and appraisal practices in residential, commercial, and construction lending; legal lending limits for mortgage banks; capital adequacy requirements on mortgage bonds and other products related to housing finance; and minimum equity requirements.

This document was prepared at the request of USAID/Warsaw for the attention of the National Bank of Poland. It reflects solely the knowledge, understanding and views of the author, and has not been reviewed by the Urban Institute Consortium or by USAID.

LIST OF ACRONYMS

A/L	Asset/liability
CFF	Crédit Foncier de France
CR	Czech Crowns
CRH	Caisse de Refinancement Hypothècaire
DIM	Dual-Index-Mortgage
DPM	Deferred-Payment-Mortgage
EBRD	European Bank for Reconstruction and Development
EC	European Community
EEC	European Economic Community
EU	European Union
GDP	Gross Domestic Product
LTV	Loan-to-Value
NBP	National Bank of Poland
OECD	Organization for Economic Development and Cooperation
PLAM	Price-Level-Adjustable-Mortgage
PLN	New Polish Złotys

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1. INTRODUCTION

1.01 The main objective of this report is to propose to the National Bank of Poland (NBP) some regulatory recommendations which could accompany the implementation of the Mortgage Banking and Mortgage Bond Act, dated as of 29 August 1997. Some directions adapted from general regulatory banking principles are required for specialized mortgage banks, as the first banking candidates have recently applied for licenses in Poland. Under such circumstances, the report is not commenting about the pertinence and efficiency of mortgage banking as an element of the housing finance policy in Poland. Nor would the report directly comment the main disposals included through the Law of Mortgage Bonds and Mortgage Banks. The report would only use the main contents of this Law (which is supposed familiar to the reader) as the main reference of the related regulatory disposals.

NBP and the Banking Supervisory Commission are hold as key regulatory and supervisory bodies of mortgage banks in Poland. The Commission is specifically granted a decision-making capacity for several key points like the minimum start-up equity (Article 11), the reserve fund (Article 17.3), the valuation guidelines (Article 22.2), the format of the cover register (Article 24.6), trustees (Article 27 to 33). It can also more generally determine any other norm of permissible risks (including liquidity one) generated by their activities (Article 34.5). NBP is also directly entitled to proceed with a specific supervision of mortgage banks, in addition to the banking supervision exercised on general basis (Article 34.3).

1.02 NBP has thus identified some issues of its specific interest, such as risk-weighting ratios, minimum capital for mortgage banks, loan lending limits, valuation methods, and investment ceilings for institutional investors. This report has extended the analysis to other key issues like the matching of cash-flows, the role of trustees, the treatment of prepayment risks and deferred interest, the differentiation of residential from commercial property credit risks, exemptions from various mandatory reserves, disclosed information about the actual quality of the assets of a mortgage bank which collateralize the issued bonds,[1] and various start-up costs. According to the terms of references of this study, some responses are also proposed to the detailed suggestions and comments made by the Polish Foundation for Mortgage Credit on this topic.

1.03 The analysis conducted for this report took into account two different perspectives:

The evolution (historic and recent) of European directives and practice about mortgage banks and bonds.

Realities of Polish mortgage and capital markets (legal, financial, accounting, banking) in relation to recent experiences in the Czech Republic and Hungary.

2. EUROPEAN UNION DIRECTIVES ON MORTGAGE BONDS

2.01 Under the proposal of the European Commission, the European Council and Parliament have approved a list of Directives which are rather favorable to institutional investors of mortgage bonds and banks holding portfolios of mortgage loans. This report refers to European Union Directives (or EU Directives), although most of existing legal references may still refer to either EEC, EC or Commission Directives. Each EU member country is required to notify the European Commission of the list of its bond issuers and bonds which would meet the definition of mortgage bonds (see below) when the directives are integrated international laws. Some countries have already given this notification to the Commission. EU Directives are discussed and recommendations for Poland as to how these directives could be applied are offered.

Mortgage Bonds

2.02 Mortgage bonds were implicitly included in the definition set by Article

[1] That is, the mortgage loans and other high-quality assets of a mortgage bank which both constitute the cover of the iss
tgage bonds in case the issuing mortgage bank becomes insolvent. The amount of mortgage bonds must not exceed such cover.
e rule applies to relation between interest on issued mortgage bonds due to investors and interest gained by the bank on mortg
is constituting the cover.

22-4 of the Directive 85/611/EC of 20/12/1985 of the concentration limits applied to Investment Funds (ceilings of purchasable securities). Funds can purchase more mortgage bonds issued by one single emitter than other private securities (25 percent instead of 5 percent-10 percent), when the assets financed by such bonds issued by a credit institution sufficiently secure the capital and interest payment of bonds by a legal privilege of bankruptcy and public supervision. The Directive does not outline operational conditions, such as a valuation standard, privileges in cases of bankruptcy, or isolated cover controlled by a trustee. The definition set by the Directive may also be applied to Refinancing Mortgage Facilities.

2.03 Only Denmark, Germany and Austria have given full notification to the Commission. Italy has done so only for earlier bonds. Several other countries are now preparing their notification under EU market pressure. Most of these countries will need to modify their internal laws and regulations in order to meet certain operational conditions, such as the bankruptcy privilege and certain loan-to-value ceilings. The European Mortgage Federation cites the cases of Sweden, Ireland, Luxembourg, Ireland, Spain, and France as illustrative of these conditions.

2.04 The renewed interest in reforms in these countries is motivated by the perspective of a growing EU bond market, thanks to an increasing interest of institutional investors for ECU-denominated securities, particularly for mortgage bonds.[2] The attractiveness of mortgage bond markets should soon be enhanced by a recent and important regulatory proposal which suggests **that mortgage bonds should be qualified without any particular rating as Tier-1 eligible securities for open-market transactions with the European Central Bank**. No further control or rating would be required, other than a country's notification to the Commission of applying the 22-4 EU Directive for its national issuers of mortgage bonds. In ambiguous cases, a consultative committee would debate the conformity of the bond with the Directive, but the decision is likely to be taken by the sovereign state.

2.05 This direct Tier-1 qualification represents a valuable signal of financial soundness granted to mortgage bonds, which will enhance their prestige among international institutional investors and may lead to a decrease in the costs of borrowing. This classification may not save the costs of commissioning a rating by international agencies for large international issuers like German banks, as some institutional investors may still demand a favorable rating by an internationally recognized agency. The expected

[2] Most of the mortgage bonds recently issued by German mortgage banks are EURO-dominated. Danish mortgage banks cated their intention to issue mortgage bonds in EUROs since Jan. 1, 1999. Most of the leading European mortgage banks (mo man, Danish, and Swedish ones) have considerably promoted mortgage bonds among international investors (notably Ameri anese, and French) and therefore expanded their traditional base of national investors.

growth of EURO-denominated bonds,[3] should also reduce yield curves (interest rates according to terms) in some European countries. The timing of this Tier-1 qualification appears to complement the expected development of European capital markets.

2.06 The base for expansion of the EU bond market was developed in recent years through efforts to issue German Mortgage Bonds (or *Pfandbriefe*) aimed to secure their sound position in international capital markets, through the development of liquid, Jumbo-type mortgage bonds. These are ordinary public low-risk bonds, meeting specific requirements as to size and trading volume. This topic is not directly treated in this report.

Specialization of Mortgage Banks

2.07 The EU definition has not required the issuers of mortgage bonds to restrict their lending activities to mortgage loans. The definition is based on a concept of a balance of assets and liabilities, in which secure loans are specifically matched to the financing of bonds. Prior to the introduction of the EU norm of mortgage bonds, mortgage banks were often specialized banks in order to be more transparent for supervisory bodies, rating agencies and investors. The main principles applied to the matching of mortgage bonds with an identified cover of eligible mortgage loans would then be more visible and controlled. Specialized banks would also improve their narrowly focused expertise in the real estate sector.

2.08 But on the other hand, this specialization of banks can reduce their profitability across sectors, concentrate risks in a single sector, and limit access to diversified funding sources. In practice, mortgage banks became subsidiaries of larger commercial banks under this historic model (mostly except for Denmark as pre-empted by regulators and to a lower extend for a few German mortgage banks). In transition countries these shortcomings would be worsened by higher start-up costs and the scarcity of equity.[4] Specialization of banks in Poland, inspired directly by the German model, may appear costly, and does not substantially enhance mortgage bonds safety, as assets liabilities matching is correct anyway, ensured through updated cover (security) register,an appointed trustee, and specific supervision requirements.[5]

[3] Expected larger and more numerous issuance of more liquid and traded securities.

[4] Czech issuers of mortgage bonds must be granted a specific license but are not required to be specialized banks. By mid-1
e banks have actually issued mortgage bonds: CMHB, Vereinsbank and Hypobank (although others are licensed to do so) but th
ırities have only represented in average between 13% and 17% of the funding of their mortgage portfolios. In the Czech Republ
found to be difficult to exclusively rely on emerging bond markets at least during a transition phase and the access to other liabil
cluding deposits was authorized. In Hungary mortgage banks are required to be specialized, but so far only one public bank
n created (the land and Mortgage Bank) although others may get prepared to obtain a license.

[5] It should be noted that there is no specific legal cover principle in Holland or Norway, but there are some specialized banks. In 1

Other European Union Directives

2.09 Institutional Investors. Following Article 22-4, other important EU Directives dealt with mortgage bonds for institutional investors, with direct reference to the Article 22-4 or by repeating a similar definition, or dealt with mortgage loans held by banks. The key objective of these directives is to favor the entrance of institutional investors on these mortgage bond markets. In all developed mortgage bond markets, investors are mostly investment funds, pension funds and insurance companies (more than 80 percent in Germany, more than 50 percent elsewhere). Even in Chile, mortgage bonds represented more than half of assets held by pension funds in 1995. Mortgage bond markets cannot grow if they are limited to banking investors even if these investors may initially represent a very important group. Regulations must reflect this so that mortgage bonds do not turn into a market composed solely of banks.

2.10 Life Insurance and Other Insurance Companies. They correspond to the Directives 92/96/EEC dated as of 10/11/92 (for life insurance companies) and 92/49/EEC dated as of 18/6/92 (for non-life insurance companies).

Under these Directives, ceilings of mortgage bonds eligible for required "technical reserves" were raised from 5 percent to 40 percent of the technical reserves.

There is no particular directive on the purchase of mortgage bonds by pension funds. Some countries like the Czech Republic apply to pension funds ceilings applied to insurance companies or investment funds.

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three mortgage banks in Holland faced severe liquidity problems; a domino effect took hold once one bank failed, and insura
ıps were then called to rescue the banks. In France the matching principles are clear but there is no cover principle, although tl
special governmental inspectors. Crédit Foncier de France, the only French specialized mortgage bank (then privately-owned
er public management) made a risky entrance into commercial property and working with developers at the peak of the real es
ket, and lost its monopoly on state-backed residential loans. CFF is now restructured after facing major losses and the objec
atization plans.

2.11 Recommendation for Poland. Approving the request from the Foundation for Mortgage Credit to modify the corresponding Laws in Poland of Investment Funds (act dated of 28/08/1997), Insurance Companies, and the debated draft law on Pension Funds would enable these groups to purchase such securities as a portion of secure assets. However, EU ceilings may prove to be too high for Poland. Lower ceilings would be recommended, at least during the early stages, at half of the 25 percent and 40 percent ratios for a single issuer (respectively for investment funds and insurance companies). The corresponding legal reforms (required amendments to the Laws on Investment Funds, Pension Funds, Insurance Companies) may be lengthy, but are presumably unavoidable. In Hungary and the Czech Republic, the respective Mortgage Bond Laws include articles which permit higher ceilings of purchasable mortgage bonds than of ordinary securities for such institutional non-banking investors.

2.12 Directive on the Monitoring and Control of Large Exposures of Credit Institutions. This EU-Directive (92/121/EEC dated as of 21/12/1992) mentions that a credit institution (including any bank) should limit its lending exposure on large credits or investments. A large exposure is determined as a consolidated amount due by one borrower (including the issuer of securities purchased by a credit institution) exceeding 10 percent of the own equity of the lending credit institution. No large exposure can exceed 25 percent of the bank's equity and the cumulated total of large exposures cannot exceed 800 percent of its equity. Such disposals are already integrated within the Polish Banking Law (Article 71 of the Banking Act of 29/08/1997 which took effect on 1/1/1998). But the same EU Directive includes an important exemption for mortgage bonds purchased by a credit institution from any issuer. This exemption is significant as it stresses the low perception of risk assigned to mortgage bonds for bondholders, which turn out to reduce the cost of funds of mortgage banks. Such exemptions are ordinary granted to public securities (also the case in Poland, but no exception so far for mortgage bonds). The EU Directive also favors mortgage banks from their assets side, as it also exempts some specific mortgage loans from the control over large exposures.

2.13 Recommendation for Poland. A certain level of exemption from large exposure for mortgage bonds purchased by banking investors can be accepted (although the Foundation for Mortgage Credit did not request it). This would favor the development of an inter-banking mortgage bond market. As an example of a compromise limit, Czech banks cannot hold as a total more than 125 percent of their own equity in mortgage bonds.

From the assets side of mortgage banks, at least during a transition phase, it is recommended not to make any exemption for mortgage loans hold as credit exposures, particularly as identified candidates focus their portfolio on more risky commercial property.

Other Regulations for the Banking Investors of Mortgage Bonds

2.14 Open Market Transactions. The Foundation asked for qualifying mortgage bonds to be eligible for NBP open-market transactions. The direct impact may remain small, as secondary bond markets are not expected to be highly liquid during an initial emerging phase, particularly if bank and non-banking investors may want to hold mortgage bonds for long periods. Yet this signal would be reassuring for institutional investors (particularly banks). It would stand in line with the Government's willingness to create a particularly new and secure linkage between real estate housing markets and private securities. It would also stand in line with the recent evolution of EU directives. This regulation is thus recommended in Poland.

2.15 Investments by Contractual Housing Savings Schemes. The Foundation for Mortgage Credit supports permitting contract housing savings schemes to invest their expected surplus of savings into mortgage bonds. There is a strong policy argument for recycling savings into housing finance which is accepted, for example, in Germany and France. Although mortgage bonds should be safe, they may not be liquid securities in Poland for some time. Both contractual saving schemes in Poland present serious liquidity risks and the possibility of excessive dependency on government subsidies, as injections of cash will likely be needed from time to time. The same parent group may also control both a mortgage bank and a contractual savings fund, which could lead to inefficient pricing. It is recommended here to limit the possibility of investment in mortgage bonds to a moderate ceiling percentage of their current treasury surpluses (once having excluded the bonds of any mortgage bank controlled by the same parent bank. This conservative position may be re-examined if both laws on housing contractual are amended to reduce their incorporated liquidity risks. Such a proposal has been prepared by the Ministry of Finances for Bausparkassen, but is still debated.

2.16 Exemption for Deposit Guarantee Schemes and Corresponding Fees. This EU directive (number 94/19/EC dated as of 20/05/1994) does not require any further effort in Poland, as Polish Mortgage Banks are already exempted of contribution to the Deposit Insurance System, by the Law of Mortgage Banks and Mortgage Bonds (its article 41 exempts mortgage banks from the disposals of the Law dated of 14/12/1994 on Banking Guarantee Fund).This exemption is justified as their access to deposits is severely restricted.

3. EU DIRECTIVES ON RISK WEIGHTING

3.01 Risk-weighting of mortgage bonds in credit institutions. (Directive N89/647/EC of 18/12/1989 about solvency ratios of credit institutions). The 20 percent ratio is generally applied, with a possible reduction to 10 percent if the ratio is generating some disruptive effects in countries where mortgage bonds play a preponderant role on national

financial markets . The 10 percent ratio has therefore been applied in Denmark, Austria, and Germany. All other countries (including the Czech Republic) have kept the 20 percent risk-weighting ratio, although further reductions may be expected soon in countries which plan to give notification to the Commission on mortgage bond issuers and issues. The 10 percent ratio may then become the dominant rule applied to EU mortgage bond markets.

3.02 The Foundation for Mortgage Credit is supporting a 10 percent risk-weighting ratio for mortgage bonds in Poland. The following comments should be noted to understand the proper background of this Directive:

Before this Directive, mortgage bonds were risk-weighted between 0 percent and 10 percent in Germany and Austria. Risk-weighting should be analyzed with historic trends.

The 10 percent risk weighting ratio exception was regarded as a temporary measure to be effective until 1/1/1998, but no new Directive has been issued to renew or extend it, nor has national law in the three countries been changed. The prevailing interpretation supports automatic renewal, as the demonstration period did not generate adverse behavior. It should be noted that any favorable treatment in this area always proves in practice to be irreversible. There is otherwise an unbearable additional cost of financing in a context of competing lower margins.

Risk-weighting is a measure that varies among different types of assets. Most countries risk-weight Treasury securities at 0 percent, Organization for Economic Development and Cooperation (OECD) banking risks at 20 percent, and local government and municipal bonds between 0 percent and 20 percent. Bonds issued by refinancing mortgage facilities (like the French CRH, or Austrian and Swiss Mortgage Refinance Institutions) are also often 10 percent risk-weighted, resulting from the dual guarantees made by the recourse nature of the refinanced banks (which still keep in balance sheet the refinanced mortgage loans), joint to the presence of backing mortgage portfolios (put to the disposal of the liquidity facility).

3.03 As of June 1998, Polish Treasury securities were still 10 percent risk-weighted, but this ratio is expected to be reduced to 0 percent shortly. Loans not benefiting from a State signature or guarantee and municipal bonds were still 100 percent risk-weighted. Loans to OECD banks were still 30 percent risk-weighted.

3.04 The Example of the Czech Republic. It is also interesting to comment on

the evolution of Czech mortgage bonds, which are issued in a looser regulatory environment and are supported by major government subsidies. Growth has been modest despite a fiscal preference for such bonds; a full interest exemption for income taxes is given at levels of 25 percent for individuals and 35 percent for corporations. This exemption is higher than the exemption for Treasury securities since January 1997 and is to remain valid until January 2000. This distortion of capital markets is large as mortgage banks could get access to an average cost of funds 3 percent below Treasury securities. This may soon exclude from the mortgage lending business those banks not licensed to issue mortgage bonds.

However, this incentive was not enough to overcome other difficulties met by the pioneering issue of mortgage bonds. Since the introduction of the Bond Act in 1993, seven banks have been licensed to issue mortgage bonds and three (CMBH, Hypo Bank, Vereinsbank) have been actually issuing bonds. They meet no specialization requirement, no trustee requirement, no specific valuation standard (until now), but a 20 percent risk-weight is applied.

By the end of 1997, issued mortgage bonds represented only 2.9 Billion Crowns (about 300 Million PLN) for a corresponding 18.3 Billion CR. portfolio of mortgage loans, of which only 16 percent are refinanced by mortgage bonds. This modest start is explained by the relatively easy access to cheap deposit resources, and by a reduced demand for mortgage loans because of some rising interest rates since mid-1997. Moreover, two of these banks are commercial-property oriented.

3.05 Recommendation for Poland. Mortgage bonds are not expected to play a significant role in capital markets in Poland's near future. Even in the medium term, their total outstanding balance should remain modest, as their growth depends on many uncertain factors such as inflation, the demand for mortgage credit, the demand of bond investors, the growth or decline of public deficits financed by Treasury securities, the evolution of savings and deposit rates. Therefore, according to the current EU definition, they do not justify a 10 percent risk-weighting.

During a transition period, if mortgage bonds are issued, a preferential risk-weighting would rather stand at 20 percent, or at best at 15 percent. This would still be a positive signal for mortgage bonds. Banks still record high capital adequacy ratios, but mortgage bonds' impact on this factor could prove more decisive in a few years.

3.06 The 10 percent risk-weighting could then be granted later, when one of the following conditions is met:

The security of bonds is enhanced by a centralized mortgage liquidity facility, or by over-collateralized loans, or any fast-track foreclosure mortgage

procedure, or by low risks demonstrated by Polish mortgage banks after a probation period;

Mortgage bonds represent a significant portion of Polish capital markets; or

Poland joins the EU when the 10 percent ratio is already universally applied as a condition of entering the market of mortgage bonds.

3.07 Risk-Weighting of Mortgage Bonds for Investment Firms. This EU Directive (93/6/EEC of 15/03/1993) mentions a 50 percent risk-weighting for mortgage bonds held by investment firms, instead of the usual 100 percent level. This is not applicable in Poland as these funds have no capital adequacy requirements yet.

3.08 EU Risk-Weighting Norm for Residential Mortgage Loans. The Directive 89/647/EC of 18/12/1989 (solvency ratios of credit institutions) mentions that the 50 percent risk-weighting is granted for owner-occupied or rental purpose instead of the usual 100 percent level. The 10 percent ratio has therefore been applied in Denmark, Austria, and Germany. All other countries (including the Czech Republic) have kept the 20 percent risk-weighting ratio, although further reductions may be expected soon in countries which plan to give notification to the EU Commission on mortgage bonds issuers and issues. The 10 percent ratio may then become the dominant rule applied to EU mortgage bond markets.

3.09 Recommendation for Poland. The 50 percent risk-weighting is recommended to be applied to first-rank mortgage residential loans. This proposal is made possible by the low level of non-performing loans on residential mortgages, as expressed during interviews with several active banks and as expected by their prudential underwriting standards (typically maximum 70 percent Loan-to-Value and 25 percent effort ratios, examination of the incomes stability). Even with difficult and costly foreclosure procedures, there is a strong motivation to repay and for Polish banks to apply prudent underwriting standards. On the other hand, there are no available disclosed statistics on this segment of the lending business (neither by the NBP, nor by the Foundation for Mortgage Credits nor by the Association of Polish Banks).

A 50 percent risk-weighting can also facilitate a long-term decent profitability to the equity investors of mortgage banks, particularly Polish investors, given the current lending margins and the capital adequacy requirements. Otherwise, mortgage banks may be encouraged to focus on more risky projects generating potentially higher profits, mostly in commercial property. However, some conditions should be attached to the 50 percent risk-weighting:

A real estate purpose of the loan, as the current Mortgage Banking Law now accepts any purpose of the mortgage loan, including corporate ones,

provided that some estate property is mortgaged (more risky corporate finance than carefully underwritten project finance generating sufficient cash-flows). Eligible purposes could include owner-occupancy, leased and mixed-use units (residential and business). By law in Hungary and Czech Republic the mortgage loans part of the cover requirement must relate to a real estate finance purpose: some bankers would complain about this lending restriction (therefore suggested in Poland to only differentiate the risk-weighting of such loans). In addition, in Czech Republic, the 50 percent risk-weighting is only granted to residential loans for owner occupancy units.

Completed real estate units (with administrative approvals of exploitation use and damage insurance). By Law (article 21.3) Polish mortgage banks are entitled to retain construction loans in their cover mass, up to 10 percent of the total. This ceiling is reasonably prudential but yet these latter loans should remain 100 percent risk-weighted.

Larger proportions of construction loans are permitted (then 100 percent risk-weighted) to mortgage banks, but they cannot be part of the cover mass and must then find alternate funding than mortgage bonds.

The 50 percent risk-weighting is recommended to be only applied to the portion of the loan below a reasonable loan-to-value ceiling (in this case 60 percent after applying valuation standards). The portion above the ceiling would remain 100 percent risk-weighted.

3.10 EU Risk-Weighting for Mortgage Loans Financing Offices or Multi-Purpose Commercial Premises. This ratio was also established by the 1989 Directive 89/647/EC, but was modified in April 1998. Until January 1996 the ratio was 100 percent, with a 50 percent exception granted to Germany, Austria, Greece, and Denmark.

Although some countries did not modify their own previously existing regulations, the 50 percent ratio was then recommended to be extended to the entire EU first until 2001 and then until 31/12/2006, provided that the following conditions were met:

The units are mortgaged and completed, either owner-occupied or leased. There are still doubts as to how to interpret the concept of "multi-purpose commercial" in cases of industrial use, hotels, clinics, golf courses, etc; most cases would be accepted in Germany but not, for example, industrial use in Denmark.

The ratio would either be applied only to 50 percent of the "market value", under reasonable sale conditions, at the lesser value resulting from two independent valuers and re-estimated at least every year if the loan exceeds one million Euros or 5 percent of the bank's equity ; otherwise, every three years.

The ratio would be applied to the lesser of 50 percent of market value and 60 percent of the "mortgage lending value," which was established as a long-term sustainable value excluding speculative market trends. The valuation and its underlying market assumptions should then be renewed every three years, or when the market falls by more than 10 percent.

3.11 Recommendation for Poland. It is recommended that the 100 percent ratio is maintained for any non-residential use. No unanimity in EU countries exists, despite recent modifications. Much higher risks remain for mortgage banks in Poland, and speculative thin sub-markets prevail. Symptoms of this include: rent increases subject to future decline, a risky developer-oriented market, under-capitalized developers, projects concentrated in a few big cities (mostly Warsaw), an unfavorable fiscal environment, volatile debt service ratios, short term leases, illiquid markets, and few institutional investors.

3.12 Other arguments against changing the ratio could be made based on the lack of experience of most lenders in a market dominated by a few developers and agents as market-makers. Polish lenders have not developed yet in this more risky sector sufficient underwriting and risk-monitoring procedures, and they often combine a credit position to an equity investor one. Many debt service ratios would not resist a possible shock of falling rents on some speculative segments of a short-term oriented and uncertain market.

The study conducted in 1997 by M. Lea and J. Łaszek on commercial property lending in Poland[6] (report for USAID and NBP) stressed a lack of specifically-developed

[6] Lea, Michael J., et. al., The Risks of Commercial Real Estate Lending. Prepared for USAID/Warsaw, December 1997.

procedures among an interviewed sample of Polish Banks. By that time, they did not appear well prepared to tackle what is traditionally and internationally considered as a more complex and speculative market than home-owner ones. In Poland mortgage banks can be expected to show some variation in quality, and more prudential standards could be expected from experienced foreign banks.

The problem is emphasized by the natural trend for mortgage banking candidates to start lending in this more complex and risky sector in order to reach more rapidly some scale effects which would justify a regular and cheaper bond funding strategy. But this trend may contradict the security required for the introduction of mortgage banks in capital markets.

3.13 Other Prudent Restrictions Concerning Commercial Property Mortgage Lending. Further steps could be taken from the following menu of suggestions:

Stricter valuation standards could be applied to this sub-sector (see the related chapter).

A maximum low percentage of such commercial property lending could be set for the total cover mass of eligible assets (selected to match the issued mortgage bonds).

Mortgage banks may be imposed some loan-to-value ceiling on their commercial property loans, in order for them to actually require some minimum equity investment from their borrowers (in order to reduce credit risks in a development market traditionally short of equity).

Mortgage banks may be required to regularly disclose to their trustees and to the NBP the breakdown of their total portfolio in amounts and number of loans, according to the nature of loan purpose (between individuals homeowners, residential developers, offices, shops, and others). Such is not the case so far. Resulting cover ratios should be calculated with a division between the main cover and the substitute cover. Rating agencies would likely request this information. Examples of this obligation can be found in the Czech Republic.

A simplified similar obligation could be set through bond prospectus for investors, also breaking down total residential loans from other loans. In addition to cover ratios, prospectus may also provide some basic information about the proceeds of funds. However, disposals about releasing recent financial audits should be lifted during the first year of activities as mortgage banks would be new institutions. The demand of

the Foundation of Mortgage Credit to eliminate any bond prospectus seems premature, as investors are not supposed to know all the details of the Mortgage Banking Law and of mortgage banks charters, particularly during a start-up phase.

The concentration limits for higher risks (geographically, by size, by sector) should be tightened. A mortgage bank may now be authorized to hold a portfolio made of 50 loans in the Warsaw A-class office market, each of them representing 14.99 percent of the bank's equity. NBP may go further in requiring asset diversification.

3.14 Starting Equity of Mortgage Banks. This level could be differentiated, according to the expected scope of activities planned by the candidate mortgage bank. This is very controversial and debated issue, which would naturally generate important and direct impacts on the profitability of mortgage banks and therefore on the attractiveness of the scheme and the number of candidates.

The minimum equity set on any regular universal bank is set at 5 Million Euros (but higher levels closer to 10 Million Euros - were actually required to newly-licensed banks). This threshold could be seen as a pertinent reference for specialized mortgage banks, which are designed by Law as particularly restricted to secure banking activities.

Some risk-adverse regulators may prefer higher levels, about 15 Million Euros for mortgage banks, because of the concentration of risks on both assets and liabilities sides, on a sector still exposed to price fluctuations, weak and costly mortgage foreclosure procedures, unequal professionalism and lack of reliable data in the real estate sector.
This latter option may discriminate a new generation of specialized banks.

Although it would be preferable and more simple to set a uniform level of minimum equity, it may prove wiser from a risk-management perspective to differentiate this level between the two above-mentioned values, according to the kind of license applied. 5 Million looks sufficient for mortgage banks restricted by Charter to the residential and public sector (safer assets) versus 15 Million for a general mortgage bank, likely to incorporate any eligible asset including large commercial property loans concentrated in one city and one sector and likely to reach a more comfortable financial situation when the accrued portfolio returns stable and significant net incomes.

4. EUROPEAN LOAN TO VALUE STANDARDS FOR MORTGAGE LOANS

4.01 Each European country applies different loan-to-value ceilings (and valuation standards: see the related chapter 5). There are two major categories.

A. Variable LTV Ceilings

4.02 The first is those countries which authorize mortgage banks to make other loans out from the cover mass. These other loans may correspond to the ineligible portion of granted mortgage loans. This part is then financed by "regular" non-mortgage bonds (then expected to present a more expensive cost of funds).

In Germany, this situation corresponds to the loan amounts exceeding the 60 percent loan-to-value and second-rank mortgage loans (this latter category is not admitted in Poland).

Uniform 60 percent ratio is applied as a loan-to-value ceiling to the main cover mass in Germany, Austria, Hungary, Poland, and France. The "unsecured" maximum portion is 20 percent in Germany and 10 percent in Hungary, with in this latter case a maximum 70 percent loan-to-value for any loan owned by the mortgage bank. There is no limit applied to licensed Czech banks, as they are not specialized, but only the 70 percent loan-to-value part of a mortgage loan is eligible to the cover (any portion in excess being then funded by other available liabilities).

4.03 Polish mortgage banks can record some mortgage loans as eligible assets but must exclude them from the cover mass. This situation corresponds to the portion of mortgage loans between 60 percent and 80 percent of loan-to-value ratios, provided that their cumulated amount represents less than 10 percent of the total portfolio of the mortgage bank. This unsecured portion is also limited in volume, because funds other than equity and mortgage bonds cannot exceed twice the equity of the mortgage bank (Article 15.2 of the Mortgage Bonds and Mortgage Bank Act). Yet a mortgage bank could be found exposed to higher-risk loans, with loan-to-value ratios close to 80 percent, which appear excessive when taking into account factors such as the low rate and inefficiency of mortgage foreclosure in Poland, and the possibility of valuation errors.

4.04 Legal issues regarding mortgage collateral in Poland. No legal study has estimated the actual delays and costs of the foreclosure procedure in Poland, given the high fees, appeal possibilities, and delays. Direct contacts mentioned that other related legal issues include poor records about the effectiveness of mortgage foreclosure, forced auctioning sale, implied costs and final eviction procedures. Lenders are given strong incentives to use alternative forms of collateral (such as general pledge over the whole patrimony of the borrower, third-party guarantees, pledged leases). This issue is important, as the Polish Mortgage Banking Law only requires the presence of a mortgage collateral. Unbiased and thorough studies should analyze this situation. Some contribution may be expected as a complementary opinion from German regulators, if ever required to measure the effectiveness of mortgage for lenders in Poland, to qualify such loans as part of the

cover of their mortgage banks.

4.05 Mortgage Banks and Statutory Liens. Mortgage Banks are exempted from the former priority granted to statutory mortgage on tax liens (without any prior registration), which were found cumbersome and unfair by many lenders of mortgage credits.

This favorable treatment represents a less important privilege now, since the amended Tax Law (applied as of 1/1/1998 according to the Tax Law of 29 August 1997 - Dz. U. Nr 137, poz. 926) have also limited removed statutory liens for long-term residential mortgage loans (fiscal authorities still have one month to register their fiscal claims). But on commercial property loans, statutory mortgages are still quite discriminatory for lenders else than mortgage banks. The Foundation for Mortgage Credits has been supporting a more general removal of statutory liens for any mortgage loan. This option is recommendable, as an extension not granted only to mortgage banks.

4.06 Much more remains to be resolved in Poland regarding the lengthy appeals possibilities through the judicial system, valuation disputes, large advance fees paid to executive foreclosure officers (often more than 40 percent of the housing value). The Foundation for Mortgage Credit and the Association of Polish Banks will probably work more on these issues, particularly from a specialized mortgage bank's perspective as these inefficiencies become serious generic obstacles to a sound development of their business. Under such circumstances, some interviewed banks appeared supportive of the mortgage banking concept rather than being really committed to implement such mortgage banking subsidiaries. They view the new mortgage banking law as a political instrument, likely to leverage further reforms in favor of mortgage rights for lenders, justified by the required credibility of mortgage bonds.

4.07 Legal privileges in Europe. It should be noted that at least during a start-up phase, mortgage banks sometimes received legal privileges either through a faster mortgage registration process (as in Denmark until the 1970s) or even by faster foreclosure and repayment procedures.

These privileges now apply in Hungary, where mortgage banks benefit from a faster registration process and of a direct ownership of estate goods for three years in the case of a defaulting borrower (better position than other lenders, despite a recent modernization of the collateral law).

In Chile, issuers of *letras hipotecarias* (designed as mortgage bonds) also benefited from a faster foreclosure procedure, which diminished the appeal possibilities of defaulting borrowers. Such privileges distort the lending competition in the medium term but may prove useful in a start-up phase to establish a minimum credibility for mortgage bonds, particularly in countries where the mortgage remains a weak collateral for lenders.

B. Standard LTV Ceilings

4.08 Other countries may not accept unsecured portfolios for mortgage banks, only eligible loans to the cover mass can be held by mortgage banks. But then various levels of Loan-to-Value ceilings are set according to the type of real estate finance and the type's associated risks. These ceilings may then prove higher than 60 percent for residential real estate:

Denmark
80 percent for housing-occupied mortgage loans (about 91 percent if the loans are in addition state-backed);
60 percent for any professional use (including commercial);
40 percent on undeveloped land.
Note that a foreclosure lasts only about 6 months.

Sweden
75 percent for residential mortgage loans
60 percent for commercial premises (explicitly excluding any industrial use)

Holland
75 percent

Norway
65 percent

Spain
70 percent (but mortgage bonds cannot exceed 90 percent of the cover)

Chile
75 percent for residential loans (inflation-indexed balances and payments)

4.09 The analysis completed by Empirica demonstrates that mortgage credit risks are much more significant at 80 percent loan-to-value ratios than at 60 percent, particularly but not exclusively for commercial property. The rating agency Standard's & Poor's stressed that even a 60 percent LTV ceiling does not eliminate the risks of final banking losses in the commercial property sector. No prudent underwriting standard can be easily established, such as effort ratios for individual borrowers or debt service ratios for project finance.

The 80 percent permitted maximum appears to the author as too high for Poland,

specifically but not exclusively as valuation standards as applied in practice are not secure enough and as mortgage still represents a weak collateral instrument for lenders.

5. ISSUES RELATED TO THE MATCHING OF ASSETS AND LIABILITIES

5.01 Main and Substitute Cover

In most countries where the principle of a registered primary cover is adopted for eligible mortgage loans, the principle of a substitute cover usually includes other safe and liquid securities. This is the case in Poland (Article 18.3 of the Mortgage Bonds and Mortgage Banks Act), as eligible assets for the substitute cover are:

limited to 10 percent of the total cover;

are restricted to cash, deposits held in NBP and Securities issued or backed by NBP, Treasury, EU States,and Multilateral Agencies (EBRD and World Bank).

This substitute cover is needed to provide some minimum financial flexibility, as eligible mortgage loans may fluctuate unexpectedly, as they may be non-performing or prepaying, and may then not be easily replaced by other eligible loans when a crisis occurs. Also, during its initial phase, a mortgage bank may be on less solid footing and will need time to build a large low-risk portfolio.

5.02 Four related issues can then be identified in Poland:

1. Assets permitted as alternate cover (security) remain safer and more liquid on the secondary market than mortgage loans being primary cover. Thus, there are no financial reasons to restrict alternate cover by 10% cap, as in practice reasonable mortgage bank management should try to minimize it anyway. It seems one could consider even higher than 10% caps could be granted as a derogation during the first years following the license. This occurs in Hungary, where higher ceiling is not applicable three years following the license.

2. Mortgage bonds others than its own ones could be added to the list of eligible substitute cover securities, as they are built to be secure and classified as such.

3. However, the bank's own issued bonds may raise problems. The

current Polish Mortgage Banking and Mortgage Bond Law quotes the case of acquiring its own bonds only with writing-off purposes. But for example, French mortgage bank CFF owns about 10 percent of its own bonds as eligible assets, which gives to the mortgage bank some financial flexibility in its A/L management. Other investors are then not directly endangered. On the other hand, the concern of accounting transparency for a better secondary market rather encourages writing these bonds off, in order to let investors aware that less bonds are actually tradable. The author recommends that a limited portion of its own mortgage bonds (maximum 10 percent) could be eligible to the substitute cover mass.

4. Cases of loan replacement are not clearly expressed. It is recommended that other eligible assets should replace loans facing late payments by more than 90 days. After such a delay, the probability of final default augments a lot in the mortgage industry. This is also a matter of policy coherency, as NBP requires any bank in such a situation to account for 100 percent loan loss reserves, that means to stand ready to absorb a possible integral loss. As a mortgage bank is designed to insure a maximum security to its bondholders, these latter should then be offered some eligible assets in the cover mass to replace the defective initial ones. This proposed requirement could also be part of the tasks assigned to trustees as defending the best interests of bondholders.

5.03 Residual interest rate risks of mortgage banks. The issuance of mortgage bonds is designed to considerably reduce both liquidity and interest rate risks of mortgage banks. But during the start-up period, interest rate risks are far from being eliminated, as the emergence of long-term mortgage bonds may prove financially difficult. Mortgage banks may initially have to face significant duration mismatches between loans and bonds. Mortgage banks would then remain exposed to interest rate risks as it may not be able to pass the whole new pricing of its funds through its existing portfolio.

5.04 Polish bonds are likely to be medium-term bonds, at best 5 year single-bullet bonds (characterized by a final principal payment and prior interest coupons). It can be noted that:

Long-term Treasury Bonds (terms exceeding 5 years, mostly 10-year ones) faced absorption problems since 1997 because of an uncertain economic forecast;

A mortgage bank should avoid issuing long-term bonds, even through floating-rate ones, if the obtained cost of funds is excessive and results in less affordable loans today and higher prepayment risks later;

First-phase business plans of candidate banks refer to 5-year bonds at best; and

5 years also represents the longest recorded term of Czech mortgage bonds.

5.05 Polish mortgage banks may then face a significant mismatch of duration between their mortgage bonds and their mortgage loans, that implies a direct exposure to severe interest rate risks, particularly through fixed-rate mortgage loans.

If the financial policy of a given mortgage bank is designed to pass whatever new cost of funds through the existing portfolio (possible through adjustable-rate-mortgage and a properly selected index) credit risks may just become unbearable if interest rates rise (for example because of a tightened liquidity situation, either general or specific to the bank).

In Hungary 80 percent of the outstanding balance of the main cover must present a maturity exceeding five years (forcing mortgage banks to issue relatively long-term bonds). This disposal would not be appropriate in Poland, as interest risks would come from the longer duration of mortgage loans over the one of bonds.

Only Denmark and Chile did not face interest rate risks, as mortgage loans were designed to present the same financial characteristics as bonds. Mortgage loans were then designed to be duration-matched (even prepayments were restricted) and the above-mentioned adverse consequences on the loan affordability due to rising rates were partially offset by inflation-proof design of the mortgage credit .

5.06 Proposals for Poland. Mandatory reserves requirements[7] are costly for Polish banks, and are designed as both an instrument of monetary policy and to reduce the usual risks generated by taken the traditionally large duration gaps recorded by Polish banks. It is recommended that mortgage banks could be exempted, provided that the calculated average difference of duration between their mortgage portfolios and issued mortgage bonds is small, i.e., perhaps less than two years. This condition would be financially more consistent than the Foundation's proposed condition of a two-year minimum term for mortgage bond.

[7] They are set as 11 percent of all term liabilities, and must held in cash at the NBP.

It would also force mortgage banks to improve their asset/liabilities management in a more pro-active way than by simply publishing their cover ratio, which only reflects an instant accounting position. Amortized, prepaid, and replaced credits would then be expected to be forecast. This advanced financial work could be helped and/or controlled by Trustees.[8]

NBP would then check the realism of hypothesis retained by mortgage banks. Future prepayments and replacing credits through the cover should not be over-estimated (to reduce on purpose the calculated duration gap. High expected prepayments would be better secured by some degree of initial over-collateralization of the mortgage bonds (that means a larger cover than the outstanding balance of bonds).

5.07 Relax the limits on alternative funding as a temporary derogation. According to the article 15.2 of the Law on Mortgage Bonds and Mortgage Banks, a mortgage bank can get access to other funding liabilities than its mortgage bonds and its own equity, only up to a ceiling equal to twice its equity. This disposal needs to be relaxed because it currently generate several adverse consequences:

Mortgage loans may have to remain in the balance-sheet of a universal parent bank until its mortgage bank subsidiary can properly issue mortgage bonds, once all conditions are met, such as a recent valuation of all related mortgage loans, the due transfer of the mortgage loans with their related rights, etc.

Mortgage banks are denied larger means to access more funding solutions in order to deal with various unpredicted situations like the recycling of higher cash prepayments, a sudden worsened duration mismatch, an adverse situation of bond markets due to political or economic tensions, etc. which may occur in emerging economies and markets.

Hence, mortgage banks may be discouraged to get involved in any above standard security for mortgage bonds issued, this in turn would affect investors perception of such bonds security.

Because of a reduced funding flexibility, mortgage banks may need to reduce their interest rate risk exposure and therefore have to reduce the proposed term of their loans, which would turn out as a strong

[8] This was described to be the role played by Coopers and Lybrand s appointed as the trustee of the Land and Mortgage Ban gary, but this point could not be confirmed.

commercial and financial discrimination versus universal banks (traditionally funded from a deposit basis).

Their left solution then consists in funding their initial portfolios by equity, that may lead to an over-capitalization, lower long-term profitability for potential shareholders, less motivated candidates for mortgage banking in Poland. In order to still return decent results, mortgage banks may have to shift their policy from residential lending to more risky commercial property. This move would rather be unwelcome by banking supervisory bodies (concerned by risks) and by governmental authorities (supportive of housing finance reforms).

Such a substitute funding of mortgage portfolios by equity, reduces the availability of cash capital of the bank, and worsens the exposure of mortgage bondholders in case of bankruptcy. The mortgage bank is less induced in to build a special equity fund reserve to better protect mortgage bond investors (this possibility is specifically open by the Article 17.2 of the Law on Mortgage Bonds and Mortgage Banks).

The limit may also prove too small to fund the cover-ineligible portions of loans, particularly for loan-to-value ratios between 60 percent to 80 percent. Yet such loans may represent a commercial necessity because of the prevailing competition with other mortgage lenders. In Poland the current standards often reach 70 percent.

Even in France (before the crisis of Crédit Foncier de France in 1991), the same limit had to be upgraded from twice to three times the equity of mortgage banks.

5.08 Foreign exchange risk rules. The Law on Mortgage Bonds and Mortgage Banks remains ambiguous on the mentioned obligation of "reduced foreign exchange risks" (as mentioned by Article 19.2).

Does it mean that general banking standards are then applicable to mortgage banks? Other EU norm also prices off-balance-sheet exposure by capital adequacy ratios.

When a mortgage bond is issued, even if the cover is then not exposed to foreign exchange risk, the overall matching may later worsen as some loans are prepaid and amortized at a different pace than mortgage bonds. In Poland, there are no developed long-term hedging products. A small exposure may thus be tolerated, yet at a lower level

than the disposals accepted for universal banks, because a mortgage bank's access to other funding is restricted. Reserves should be made if foreign exchange position grows above a minimum level of tolerance.

5.09 There is another implicit foreign exchange risk passed to the borrowing clients of a mortgage bank, when this latter starts lending in other currencies than the incomes of borrowers. In case of unexpected fluctuations of the foreign exchange rate, credit risks may considerably deteriorate. The reliability of the main cover for mortgage bondholders could then be seriously questioned. This is a major risk for a specialized mortgage bank. NBP may decide to ask mortgage banks accounting for this risk through their reserve fund.

If considered as a hedge against general risk arising from banking operations, it could be treated as Tier-1 core capital (Article 127 &2 of the Banking Act dated as of 29/08/1997).

A problem may occur if necessary reserves exceed the general limits set by the Banking Act (Article 130 &2.), as the involved risks can become considerable in case of a devaluation shock for example. The Commission for Banking Supervision may want to pursue its analysis on this particular point.

5.10 Ratio between the equity and the net balance to circulating mortgage bonds. The Article 17.1 of the Mortgage Banking Act imposes a ratio of equity to net balance of mortgage bonds in trading ratio amounting to 1:40. Such ratio would be useful for zero-risk weighted loans or for loans guaranteed by state entities; in the cases capital adequacy ratios are fully sufficient.

5.11 Treatment of Deferred Interest. There are two general points valid for any bank, and a third specific point for mortgage banks:

1. For both loans and bonds, deferred interests are accounted on a cash or accrual basis. Currently, they are accounted on a cash basis (that is, not accounted as income until interest is actually paid), except for the Mortgage Fund's refinanced mortgage loans (dual-indexed-mortgages). It is recommended that the short-term returns of banks would be significantly improved by accounting on an accrual basis, which could be viewed as acceptable if underwriting safeguards were to secure the final amortization.[9] It would also

[9] In Polish practice, a 1.2 percent minimum ratio between the first monthly payment of a dual indexed mortgage and the origin[illegible] amount should be applied. It is not met now by all loans made by PKO BP and even by some participating banks of the Mortg[illegible] d. This limit also corresponds to a minimum payment rate of 10% plus the bank's margin for deferred-payment mortgages. Ra[illegible] uld be adapted to individual products and conservative economic forecasts.

help to level the playing field between favored hard-currency-denominated and domestic currency loans.[10]

2. For loans and bonds, are deferred interests taxed on a cash or on an accrual basis? Currently, deferred interests are taxed on an accrual basis; banks must pay income taxes now, except on the loans refinanced by the Mortgage Fund, which are taxed only when interest is paid (but then with required reserves for deferred taxes). This tax treatment is the opposite of the accounting treatment. It is recommended to keep the tax treatment in line with the accounting method. If the cash solution is applied, a 100 percent-reserve requirement for deferred taxes should be required. Then the net results, benefits and dividends of the mortgage bank would not be modified by the regulatory choice which is unbiased to any consideration of profitability. But this choice would still generate positive outcomes as far as net cash-flows of the bank are concerned.

3. Interest matching for mortgage banks (Article 18.2 of the Mortgage Banking Act).

4. The Law requires the interests constitutive of incomes (that means now excluding deferred interests from the assets' side) must exceed at any time all due bond interests (that means now including deferred interests from the liabilities' side). A better interpretation of the original text would rather consider a matching based on a cash-flow symmetrical basis.

5. No mortgage bank could otherwise even try to issue indexed bonds to fund more affordable loans, such as DIM (Dual-Index-Mortgage), DPM (Deferred-Payment-Mortgage), or PLAM (Price-Level-Adjustable-Mortgage), because they would still have to face accounting losses during the initial years. Mortgage banks are thus prevented from competing on such alternative" products, which still dominate the market, given current interest and inflation rates. They should not have to wait for stable markets.

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[10] The balance of hard-currency-denominated loans is re-estimated in Polish currency by foreign currency exchanges. This resul
ative amortization when the Złoty is nominally depreciated in the long run because of inflation and foreign exchange incomes for
k. Such is not the case for affordable Polish currency loans incorporating a period of negative amortization, although this represer
lar profile of flows. This discrimination is unsafe, as it encourages banks to pass significant foreign exchange risk to househc
ere default risks for the bank could occur in the case of a possible devaluation shock.

5.12 Redemption Date and Prepayment Risks. The Article 21 of the Mortgage Bonds and Mortgage Banks Act imposes a minimum 5-year redemption period. This disposal is inspired by the 10-year German period during which mortgage bonds (fixed or floating rates) are not callable. Polish Mortgage Banks have the option to symmetrically prohibit prepayments from fixed-rate mortgage credits for 5 years.

5.13 But most loans and bonds in Poland are likely to remain at adjustable rates for some time because of the expensive premium for inflation uncertainty included in long-term fixed-rate mortgages. These latter would also convey higher prepayment pressure than adjustable-rate ones. It would have been preferable not to disregard callable bonds, as some investors may have accepted relatively low prepayment risks. For example, most Danish mortgage bonds are callable by issuer before the expected term, unlike in Germany. But any change would now require an amendment to the Law, which may not look very appropriate given the urgency of a prompt implementation phase of mortgage bonds. But any redemption period should be clearly indicated in the bond prospectus.

5.14 The use of the prepayment ban option is more disputable in Poland. Only a few fixed-rate-mortgages exist in Poland but they carry a strong prepayment pressure, under the likely scenario of declining rates. The prepayment ban option for mortgage banks may prove commercially unsustainable; clients could threaten to close all accounts from parent banks. However, this ban is tactically aimed at improving the legal protection of Polish lenders. This ban may still be successfully contested by borrowers defending consumer rights included in the Civil Code. The prepayment ban does not encourage mortgage banks to properly price their actual prepayment risks with some appropriate ex-ante or ex-post fees according to different cases and motivations for prepayments. For example, a motivation to refinance loan cheaper differs from "natural" causes such as death or resale, and corresponds in many countries to a differentiated system of prepayment fees.

5.15 More explicit definition of the role of Trustees. The restriction of trusteeships to Polish citizens is illegitimate from an EU perspective. This function could also be performed by a company, and it should then be made it clear that it cannot be the bank's auditor (not the case so far). His independence could be restricted than the disposals of the Mortgage banking Act; it should notably be more clearly delineated that there can be no form of business relationship between the trustee and his/her relatives and the related mortgage bank.

More information is expected to be disclosed about their fees. The Law determines the nature of their control both over the eligibility of cover assets, and the respect of matching requirements. But their exact responsibilities are not sufficiently detailed in the adverse case of a required transfer of the portfolio from a defaulting mortgage bank, which

proved unable to meet its payment obligations about the coupon or principal of its mortgage bonds. The trustee is then responsible for managing the prompt evaluation of the portfolio, the continuous servicing of mortgage borrowers (otherwise cash-flows may be interrupted), or and sale of the portfolio under the best possible conditions (does it mean for example to sell in priority to another mortgage bank likely to carry the responsibility over the prior bonds?).

Such functions may require an in-depth and updated understanding of Polish mortgage markets. A trustee should not then be only an administrative or a passive echo-chamber for registered loans (see the Hungarian counter-example of a pro-active trustee, closer to the role of a permanent asset-liabilities management). Other points in this report described their role in the disclosure of cover ratios and valuation.

6 VALUATION STANDARDS APPLIED TO MORTGAGE BANKS

6.01 Some detailed, practical and conservative standards and methods must be imposed to insure the high quality of the valuation process of the mortgage loans constitutive of the main cover mass of a mortgage bank. The valuation has to take into account the actual market value of mortgage assets in order to identify those lower-risk loans eligible to protect and match at any time mortgage bond holders.

In this regard, the Law on Mortgage Bonds and Mortgage Banks gives further regulatory responsibilities to the Banking Supervisory Commission (article 22.2). The proposals of proper valuation guidelines made by the Association of Polish Banks are not recommended as they rather remain vague and in line with general valuation standards applied in Poland. Little work was included to take into account the specific long-term implications for the matching of mortgage bonds. The same reproach could be made, but to a much lesser extent, to those proposals of the Foundation of Mortgage Credit. The valuation topic has been the object of animated controversies in the EU and in Poland. It represents a key element of security but also an interesting new business for appraisers, and an additional potential cost in particular for mortgage banks.

6.02 The problem is made more complex in Poland, as the new and high standards of professionalism promoted by the Association of Valuers and the new certification process applied since 1994 represent very important pieces of progress, but they cannot guarantee a general label of quality as far as current practices are concerned, even if the main methods correspond to the usual western standards. In Poland price databases for various segments of real estate markets are scarce and often unreliable. Some segments of real estate markets remain thin, and concentrated in major urban centers. Despite good progress, the quality and professionalism of valuers varies greatly.

6.03 Two major schools of thought on valuation were developed in Europe for the purpose of mortgage bond coverage:

1. Spot market valuation (under reasonable sale conditions);

2. Long-term mortgage lending value obtained by applying more conservative standards, to be included in whatever regulatory form: part of the mortgage banking law, specific decree, ordinance or regulation set or approved by the financial or the supervisory authorities of mortgage banks.

6.04 In 21 January 1998 the EU Commission drafted a recent amendment to the Directive 89/647/EEC on solvency ratios for credit institutions: a key factor for applying favorable risk-weighting to mortgage loans is the loan-to-value ratio, as resulting from a market-oriented valuation of the mortgaged estate. This amendment clearly admits the presence of these two valuation schools, as it respectively differentiates the LTV ceilings according to the selected method (50 percent in the former case, and 60 percent for the latter). This also implies that the expected average difference between two methods stands about 12.5 percent of the house value.

Some EU countries find a compromise between these "extreme" definitions. During many years, no agreement could be found between each EU state member on the issue of an unique valuation path for mortgage bond purposes.

6.05 The "natural" function of a reliable expert consists in first determining the market value. Then special conservative rules or discount factors may be integrated to obtain a more prudent value which excludes any speculative assumption which would just extrapolate future trends of real estate markets as close to the current situation. In Denmark mortgage banks are specifically requested to discount through their appraisals any speculative trend on real estate markets. Valuers can be asked to present sensitivity tables according to various assumptions and rules, as in a prior agreement between the valuer and the bank. The main essential parameters are listed through next paragraphs. For example, mortgage banks must order Valuers whether the valuation should suppose a

stressed scenario, in which the bank does not dispose of reasonable marketing conditions for the resale (this hypothesis is a regulatory requirement in France or Italy).

6.06 The requirement of retaining only the long-term character of a valued estate is then necessary but not sufficient. Who stands as responsible for applying conservative discounts from a market spot value:The valuers' responsibility would be enhanced by mandatory liability insurance if they are not respecting professional standards. It is recommended the Banking Supervision Commission puts clearly forward the above issues in valuation guidelines.[11]

6.07 These valuation guidelines must be as precise as possible. Czech authorities are now preparing a new set of specific valuation standards after some recent problems.

Neither NBP nor the Commission should publish any list of valuers of their own; but they must keep the right to reject any appraiser estimated not to respect the guidelines.

6.08 Guidelines must mention that the selected valuers must be paid by the requesting mortgage bank and must address their reports exclusively to the bank (up to this latter then to give copy or preferably a summary to the borrowers, particularly if these latter pay fees for this purpose). Their fees should be independent from the estimated values (not "ad valorem" , that means expressed as a percentage of the estimated value).

6.09 By Law, valuers are requested to be independent, but this condition is a difficult objective. Prudent and knowledgeable banks tend to control their appraisers by keeping them on their payroll. Outsourcing may prove easier in developed markets than in Poland. Sometimes as an additional security in some EU countries, appraisal reports must be signed by an external chartered surveyor or auditor. The commercial pressure in a bank may be intense to grant "important" loans, and there may be financial pressure to make a loan eligible to cover cheaper mortgage bonds. It is recommended that a mortgage bank's credit committee orders the report and is responsible for its formal approval.

But neither the Committee nor the Board is then allowed to modify the first estimated value, except when:

Another valuation was ordered by the mortgage bank to a different valuer;

There is a written decision of the Board, justified by strong arguments;

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[11] In the Mortgage Bonds and Mortgage Banks Act neither NBP nor Banking Supervision Commission has such prerogat
nslator s comment).

In both prior cases, the initial and new values would preferably be notified to the trustee (up to him to contest the reduced new value if there are any doubts).

6.10 In the case of larger credit risks, two separate independent valuations could be mandatory. This dual security mechanism could be particularly required for "larger" loans as determined by the following possible cases:

above 1 Million Euros;
loan-to-value above 70 percent;
loans classified as large exposures;

Duplication of valuation costs would be moderate for large loans (as costs are not pro-rata to the size of the loan).The timing of any renewal valuation could be set at every three years. Hiring a new valuer is still an open question (a different one would guarantee more independence but larger costs).

6.11 Cases When an Appraisal May Generate Negative Effects. A systematic appraisal report may not be required in some specific secure cases, when loan amounts are small as expressed as a percentage of the documented invested value (less than 30 percent or 40 percent), except if the real estate asset presents characteristics likely to deteriorate its market value (rare type, isolated location, rare or none comparable transaction, specific use of the building, etc.,). Significant savings could still be spared to mortgage banks. Normal clients are not expected to over-pay more than twice market values; on the contrary, they tend to under-declare official prices for tax purposes.

Below such levels (30 percent or 40 percent), a loan which would not have required an appraisal is unlikely to correspond to an actual market LTV above 60 percent, that means to illegitimately be part of the cover mass for mortgage bonds. Such should remain the main objective of trustees and of supervisory bodies.

The security of their bonds should not turn out in a discrimination of mortgage banks by excessive costs on residential loan markets against the current practices of universal banks, which tend to rarely require a separate appraising when loan amounts remain modest relatively to the declared housing value (current majority of applied housing loans).

6.12 Most Preferable Applied Valuation Method. The spot market value represents a maximum, that must not be exceeded even if other methods lead to superior amounts.

The method of discounted cash-flows from net incomes is preferable for any developer loan (residential or commercial), residential leasing project, any non-residential purpose, particularly for office and multi-purpose commercial property. It is important to caution banks that developers' and investors' business plans are generally overly optimistic and that banks and developers operate with asymmetric information. The bank making the loan cannot know the resale value or potential gains from resale, and the bank will have less clear and accurate information than developers and investors have.

6.13 The following are a few additional points about the application of this method in Poland: How many years of discounted incomes? The lower number of years between:

the accounting amortization residual period;

residual leasing years in case of perpetual leaseholds;

residual exploitation according to obsolescence tables; and

an absolute conservative ceiling (below 15 years, as the following years would not change much of the final value when applying conservative discount rates).

How to obtain the net incomes before applying actualization rates:

take the lesser from contracted rents and average market ones on a similar market;

consider the rents which correspond to a leasing term as close as possible to the loan one; there are in Poland large term gaps and then long-term rental discounts (up to 50 percent), and

deduct at least 20 percent as of exploitation costs (perhaps more for commercial property).

Which actualization rates to apply:

Conservative rates should be disclosed in the mortgage bank's valuation instructions. The Commission’s guidelines would preferably set and adjust some minimum yearly rates. Different actualization rates must apply to PLN and hard-currency loans, according to realist foreign exchange assumptions. In Złotys, a minimum could

be the current inflation (between 10 percent and 11.5 percent forecast in 1998) plus a fixed real rate (at least 4 percent for housing and 6 percent for commercial property). DM rates should be at least 3 percent-4 percent higher than the ones applied in Germany (currently 5 percent for residential and 7 percent for commercial property applied by German banks for loans out of Germany). Commercial property should face more discrimination in Poland, as it is more risky; internal rates of return are expected by investors to exceed 18 percent in USD as a reflection of local risks.

6.14 For residential owner-occupancy mortgage loans, the comparative price method should be preferable to the cost replacement method. This supposes that a minimum number of reliable priced transactions have been made during the previous six months. The cost replacement method should be viewed as a last-resort method when none other can be applied because the unit is too specific or there was no identified corresponding market price (particularly outside of large cities).

6.15 NBP should make it clear that banks and valuers should make efforts to improve their price database when it is possible. Very limited progress has been made because of the lack of business cooperation. Accepting the cost replacement method as a general method would give no such incentive. Yet most valuers, who have engineering backgrounds, feel more comfortable with the method that requires no database, but which may lead to some over-appreciation of values, to the detriment of the mortgage bank's security.

7. OTHER INDIRECT REGULATORY ISSUES

7.01 Mortgage inscription fees (such as Court, Notary, and Tax fees) should be exempted when any mortgage loan is sold to any other creditor and the registration of the mortgage title in the Land and Mortgage Book is consequently transferred. Such fees should be paid only once during the first inscription of a mortgage. This measure would facilitate the liquidity of any form of secondary mortgage markets. It would particularly but not exclusively help mortgage banking subsidiaries not to pay a second time when portfolios of mortgage loans are transferred from parent banks (which originated or bought them). This disposal would also contribute to lift one financial obstacle to the creation of a centralized mortgage bank, which would buy standardized mortgage loans from various primary originators/ shareholders (still servicing the loans after the transaction) and then issue securities (preferably also classified as mortgage bonds). It also maters that during such a sale transaction, a mortgage bank would not be subject to VAT taxes.

In the case of a transfer of any mortgage loans, any stamp duties corresponding to the sale of assets should also be exempted, not only for mortgage banks. At the first registration of a mortgage right, the current fees would also be preferably reduced, particularly for non-housing loans. For example, the current court fee is 1.26 percent of a commercial property loan of 100, 000 PLN, which is quite high. This would help to support the development of a primary mortgage market. It would then contribute to favor an hospitable environment for mortgage banks, without granting them any specific privilege versus other mortgage lenders.

7.02 NBP and the Banking Supervisory Commission may want to further scrutinize the demonstrated profitability of mortgage banks corresponding to the business plan submitted by the companies/legal persons applying for mortgage banking license during the selection licensing phase. Some candidate banks may have under-estimated the costs of some aspects, such as:

Valuation costs (when buying portfolios from parent banks, or when rolling over bonds);

Registration mortgage fees; and

Issuance costs of bonds (various fees: administrative, underwriters, rating agencies).

Business plans should visualize at least a 10-year period. Foreign banks should have their business plans reviewed by their local representatives

7.03 Because of issuance costs, the Foundation's request to obtain a fast-track procedure of authorization for a mortgage bank to issue its bonds, is positively recommended, because of the specialization imposed to mortgage banks and the interest risks resulting from delays. Yet, even if under a summarized format, bond prospectus should be maintained.

7.04 Another way for a Central bank to support the development of a mortgage bond market would focus exclusively on the expected problems of liquidity of such securities on secondary markets.

In this respect, NBP may want to give further investigation over the role developed in Chile by the Central Bank while *letras hipotecarias* (mortgage bonds) were developed as a main source of market-oriented long-term housing finance as part of a policy developing bond markets. The Central bank created and financed a Regulation Fund in the 1970s. This fund played the role of a market-maker at market conditions to guarantee some minimum liquidity to mortgage bond markets, as well as an additional supervisory role. It disappeared after the 1980s, as mortgage bonds became well-traded with significant volume. Such a project could prove helpful during a preliminary stage in Poland. This would be consistent with a strategy oriented to develop investment and pension funds.

That is, the mortgage loans and other high-quality assets of a mortgage bank which both constitute the "cover" of the issued mortgage bonds in case the issuing mortgage bank becomes insolvent. The outstanding balance of all mortgage bonds can never exceed the outstanding value of this hedging cover. The same principle of congruence is applied between the due interests of the bonds and the financial interests derived from the assets

withheld as the cover.

Such ceilings were claimed by Danish mortgage banks because Danish investments funds were then saturated with mortgage bonds (which represent about 55 percent of Danish bonds and 110 percent of GDP). They are dominated by three main issuers. Despite a larger number of competing German mortgage banks, German investment funds were also sometimes saturated by a 10 percent limit on one single issuer. Germany and Denmark were active in developing EU Directives; they represent the largest mortgage bond markets in Europe. An interviewed representative of the French mortgage bank CFF (Crédit Foncier de France) also mentioned that French investment funds were saturated in 1992 with CFF bonds. French experts are now working on modernizing the Decree on Mortgage Banking by integrating EU norms for mortgage bonds.

Such specialized central vehicles (as in France, Switzerland, and Austria) only issue bonds to fund loans to primary lenders. These refinancing lines are backed by some identified portfolios of eligible mortgage loans. In case of a defaulting primary lender, these mortgage portfolios would be actually transferred without delays and in priority to the central institution, which can then either pass this privilege to its own bondholders, or de facto have no creditors other than its bondholders.

Most of recently-issued mortgage bonds of German Mortgage banks are Euro-denominated. Danish mortgage banks also indicated their intentions to issue mortgage bonds in Euros since 1/1/1999. Most of leading European mortgage banks (mostly German, Danish and Swedish ones) have considerably promoted mortgage bonds among international investors (notably American, Japanese and French) and therefore expanded their traditional basis of national investors.

Expected larger and more numerous issuance of more liquid and traded securities. Czech issuers of mortgage bonds must be granted a specific license but are not required to be specialized banks. By mid-1998 three banks have actually issued mortgage bonds: CMHB, Vereinsbank and Hypobank (although others are licensed to do so) but these securities have only represented in average between 13 percent and 17 percent of the funding of their mortgage portfolios. In the Czech Republic, it was found to be difficult to exclusively rely on emerging bond markets at least during a transition phase and the access to other liabilities including deposits was authorized. In Hungary mortgage banks are required to be specialized, but so far only one public bank has been created (the land and Mortgage Bank) although others may get prepared to obtain a license.

It should be noted that there is no specific legal cover principle in Holland or Norway, but there are some specialized banks. In 1982 the three mortgage banks in Holland faced severe liquidity problems; a domino effect took hold once one bank failed, and insurance groups were then called to rescue the banks. In France the matching

principles are clear but there is no cover principle, although there are special governmental inspectors. Crédit Foncier de France, the only French specialized mortgage bank (then privately-owned but under public management) made a risky entrance into commercial property and working with developers at the peak of the real estate market, and lost its monopoly on state-backed residential loans. CFF is now restructured after facing major losses and the object of privatization plans.

These reserves must be invested in eligible safe liquid assets in order to secure future payment for damages out of insured risks. German insurance institutions can invest up to 30 percent into mortgage bonds.

They cannot hold more than 10 percent of the amount of mortgage bonds issued by one emitter. This ceiling stands as a compromise below the more generous EU 25 percent standard, which may be explained by a transition period for these new mortgage bonds to gain credibility.

In the Czech Republic, they cannot hold more than 10 percent of the amount of mortgage bonds issued by one emitter. This ceiling stands as a compromise below the more generous EU 25 percent standard, which may be explained by a transition period for mortgage bonds to gain credibility.

Those subject to a safe and renewed valuation, plus for those loans corresponding to a non-residential real estate purpose, the required presence of commercial leases.

As these securities return higher yields than Treasuries for a good security and a favorable eligibility to various regulatory requirements.

Municipal and other local government bonds are often risk-weighted at 0 percent, particularly when, as per another EU Directive, the funded projects would generate some identified income and there are "institutional arrangements reducing default risks" (e.g. public guarantees).

The 100 percent risk-weighting of municipal bonds still remains appears unjustified. If unchanged, there should be pressure to widen the definition of eligible assets matching public mortgage bonds to the loans made to or guaranteed by local governments, whether such loans are guaranteed by mortgages or not. This the case in Germany, as this segment of the market appears to be very profitable for mortgage banks.

In addition to the collateralized mortgage loans, they benefit from the recourse guarantee and capital investment of several primary banks, which still hold and service the refinanced loans.

"Fully leased" was initially mentioned, but this condition was abandoned in the final version. Determined by taking into account Tier-1 and Tier-2 capital.

See in 1998 the investment taken by the European Bank for Reconstruction and Development in the Pioneer Estate Fund, so that to purchase completed and leased projects, as a remedy to the liquidity issue and as a way to better secure an equity position.

By international comparison of minimum equity for mortgage banks:

50 Million DM in Germany (about 25 Million Euros),

20 Million Euros in Denmark,

3 Billion Forints in Hungary (about 10 Million Euros, which means 50 percent more than an universal bank in Hungary).

This unsecured portion was recently raised from 15 percent to 20 percent of the total portfolio, as a result of some intense commercial lending pressure and satisfactory past repayment records.

In Hungary, there is still only one licensed mortgage bank, the Land and Mortgage Bank, which started its activities in March 1998 mostly in mortgage loans, agricultural loans and local government bonds. 85 percent of its shares are public-owned. Two other banks may be mortgage banking candidates, a foreign bank and OTP, which is the dominant mortgage lender.

A normal requirement for a mortgage bank is that at any time there should be more cover asset balances (mostly mortgage loans respecting a LTV ceiling) than circulating mortgage bonds. In Spain this requirement is more rigorous, as the volume of circulating bonds cannot exceed 90 percent of "covering" loans. Even if the maximum LTV for qualifying eligible assets is a bit higher than in other countries, there are larger volumes to protect bondholders. The maturity of loans can reach 20 years and stands in average about 10-15 years (both for residential and commercial property loans), which leads to a duration of 8-10 years, still exceeding realistic expectations of bonds (at best five years).

Loans are Price-level-Mortgage-Mortgages, that means that both the credit rate applied on the balance and repayments are indexed on the same inflationary unit, so that to maintain the real amortization of the loan in real terms and stabilize effort ratios of borrowers, as long as their incomes vary in pace with inflation. They are set as 11 percent of all term liabilities, and must held in cash at the NBP.

This was described to be the role played by Coopers and Lybrand's appointed as

the trustee of the Land and Mortgage Bank in Hungary, but this point could not be confirmed.

In Poland the foreign exchange open positions (net A/L) of banks are limited to:

Less than 15 percent of the bank's own equity over one single foreign currency,
Less than 40 percent of the bank's equity when accruing all open foreign exchange positions in various currencies.

One method: 5 percent of the corresponding asset risk-weighted (for any position open over 1 year). In Polish practice, a 1.2 percent minimum ratio between the first monthly payment of a dual indexed mortgage and the originated loan amount should be applied. It is not met now by all loans made by P.O. BP and even by some participating banks of the Mortgage Fund. This limit also corresponds to a minimum payment rate of 10 percent plus the bank's margin for deferred-payment mortgages. Ratios should be adapted to individual products and conservative economic forecasts.

The balance of hard-currency-denominated loans is re-estimated in Polish currency by foreign currency exchanges. This results in negative amortization when the Złoty is nominally depreciated in the long run because of inflation and foreign exchange incomes for the bank. Such is not the case for affordable Polish currency loans incorporating a period of negative amortization, although this represents a similar profile of flows. This discrimination is unsafe, as it encourages banks to pass significant foreign exchange risk to households: severe default risks for the bank could occur in the case of a possible devaluation shock.

Components of indexing coupon payments on inflation, such as Chilean mortgage bonds, include: a fixed term, an attractive constant deflated yield, and deflated constant real payments offered to investors (instead of the fixed nominal interest coupon, which in fact return declining real payments except for the final payment).

The most elaborate and recent study in these matters is the one conducted by J-H Duebel and M. Lea on Prepayments of Mortgage Loans in Europe.

One favorable interpretation would exempt mortgage banks, as the purchase of mortgage loans is clearly listed as part of their eligible banking activities (Article 12 of the Mortgage Bonds and Mortgage Banks Act). This classification directly qualifies for the exemption. But mortgage securitization is not explicitly listed as a possible activity of a universal bank.

APPENDIX 1

APPENDIX I

CITED LEGAL ACTS AND REGULATIONS BINDING IN POLAND

Act on Mortgage Bonds and Mortgage Banks of August 29, 1997 (Journal of Law of 1997 No.140, item 940). The Act was enforced on January 1, 1998.

Act of 29 August 1997 The Banking Law (Journal of Law of 1997 No.140, item 939). The Act was enforced on January 1, 1998.

Act on Registered Lien and Register of Liens of 6 December 1996 (Journal of Law of December 16, 1996, Journal of Law 96.149.703, body of the text: Journal of Law 96.149.703 01-1-1998, amendments Journal of Law 97.121.769)

Act of August 29, 1997 The Tax Code (Journal of Law No.137. item 926)

Act of March 22, 1991 Law on Public Trading in Securities and Mutual Funds (Journal of Law of 1994 No.58 item 239, corrected Journal of Law of 1994 No.71 item 713, amendments Journal of Law of 1994 No.121 item 591; of 1996 No.45 item 199 and No.75 item 554; No.106 item 496; No.149, item 703 and Journal of Law of 1997 No.30 item 164; No.88 item 554; No.118 item 754; No.139 item 933). On January 4 1998, when the Act on Public Trading in Securities (Journal of Law of 1997, No.118 item 754) was enforced the Act of 1991 ceased to be binding.

Act on Investment Funds of August 28. 1997 (Journal of Law dated November 20, 1997; Journal of Law 97.139.933 primary text, Journal of Law 97.139.933)

Act on Accounting of September 29, 1994 (Journal of Law No.121 item 591 and of 1997 No.32 item 183; No.43 item 272; No.88 item 554; No.140 item 939 and No.141 item 945)

Act of April 23, 1964 The Civil Code (Journal of Law No.16 item 93; of 1971 No.127 item 252; of 1976 No.19 item 122; of 1982 No.11 item 81; No.19 item147; No.30 item 210; of 1984 No.45 item242; of 1985 No.22 item 99; of 1989 No. 3 item 11; No. 33 item175; of 1990 No.34 item 198; No.55 item 321; No.79 item 464; of 1991 No.107 item 388; No.105 item 509; of 1995 No.83 item 417; No.141 item 692; of 1996 No.114 item 542; No.139 item 646; of 1997 No.43 item 272; No.149 item 703 and No.115 item 741).

CITED LEGAL ACTS AND REGULATIONS BINDING IN EUROPEAN UNION

Council Directive 85/611/EEC of 12 December 1985on the concentration limits applied to investment funds.

Council Directive 89/647/EEC of 18 December 1989 on a solvency ratio for credit

instructions. Official Journal No. L 386, 30/12/1989.

Council Directive 91/633/EEC of 3 December 1991 implementing Directive 89/299/EEC on the own funds of credit institutions. Official Journal No. L339, 11/12/91.

Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive). Official Journal No. L 228, 11/08/1992.

Council Directive 92/96/EEC of 10 November 1992 on the coordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC (third life assurance Directive). Official Journal No. L 360, 09/12/1992.

Council Directive 92/121/ EEC of December 1992 on the monitoring and control of large exposures of credit institutions. Official Journal No. L 029, 05/02/1993.

Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investments firms and credit institutions. Official Journal No. L 141, 11/06/1993.

Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes Official Journal No. L 135, 31/05/1994.