

3.24 POLAND

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I. FRAMEWORK

The legal basis for covered bond issuance in Poland is "Act on mortgage bonds and mortgage banks" of August 29, 1997; Journal of Laws no. 99, item 919 (List Zastawny Act – hereafter: LZ Act). There is also a special chapter concerning bankruptcy of mortgage banks in the new Bankruptcy Act - *Article 442 – Article 450* - Bankruptcy and Reorganisation Law of 28 February 2003.

II. STRUCTURE OF THE ISSUER

The issuer is a specialised mortgage bank, licensed by the National Bank of Poland.

A mortgage bank may only engage in the activities specified in the LZ Act.

According to the Article 12 LZ Act, **the core operations** of mortgage banks include:

- > Granting credits secured with mortgages;
- > Granting loans not secured by mortgage, only if the borrower, guarantor or underwriter of a loan repayment to its full amount, including the interest due, is the National Bank of Poland, Central European Bank, governments or central banks of the European Union states, Organisation for Economic Cooperation and Development, excluding those countries, which are or have been for the past 5 years restructuring their foreign debt, or by means of a guarantee or security granted by the State Treasury;
- > Acquisition of other banks' receivables on account of loans granted by them, secured by a mortgage and receivables on account of credits not secured by a mortgage, granted to the entities of the local self-government;
- > The issue of mortgage bonds the base of which constitute the Bank's receivables on account of the granted loans secured by a mortgage or purchased receivables of other banks on account of the loans granted by them secured by mortgage;
- > Issuing public mortgage bonds on the basis of:
 - a) the mortgage bank's receivables arising from its credits not secured by mortgages referred to in the second bullet (above);
 - b) purchased receivables of other banks arising from their credits not secured by mortgages referred in the second bullet (above).

According to the Article 15 LZ Act, **apart from core operations** referred to in Article 12, mortgage banks may engage in the following activities:

- > Accepting term deposits;
- > Taking credits and loans;
- > Issuing bonds;
- > Safekeeping securities;
- > Purchasing and taking up shares and stocks of other entities whose legal form limits the liability of a mortgage bank to the sum invested insofar as it helps the performance of activities of a mortgage bank, where the total value of purchased or taken up shares and stocks may not be higher than 10% of the mortgage bank's equity;

- > Keeping bank accounts for servicing investment projects financed through credits granted by a mortgage bank;
- > Providing consulting and advice with respect to the property market, including help in establishing the mortgage lending value of the property;
- > Managing receivables of a mortgage bank and other banks arising from credits referred to in Article 12 LZ Act, as well as granting these credits on behalf of other banks on the basis of relevant cooperation agreements.

All the listed activities may be executed also in foreign currencies upon obtaining relevant authorizations.

Under the LZ Act, the range of activities that can be performed by mortgage banks is specified in a closed catalogue as mentioned above. Particularly, mortgage banks cannot collect deposits of individual saver. The narrowing of activity of mortgage banks facilitates the development of a simplified and clear activity structure (which facilitates supervision, especially external one), the specialization of the loan division and an improvement in methods of credit risk assessment in the field of real (estate) property financing. Due to the above limitations, funds resulting from the issue of mortgage bonds are mainly used towards the financing of the lending activity.

The issuer holds the cover assets on his balance sheet. The covered bonds are direct, unconditional obligations of the issuer.

III. COVER ASSETS

All covered bonds must be fully secured by cover assets. There are two specific classes of the covered bonds: *hipoteczne listy zastawne* (mortgage covered bonds) and *publiczne listy zastawne* (public covered bonds); registered in two separate cover registers.

The cover register for mortgage bonds

The LZ Act provides for a cover register for the mortgage assets, which will be used in the cover pool for the mortgage covered bonds.

There is also a provision for substitute assets, which is limited to 10% of the cover pool and comes from the asset categories below:

- > In securities issued or guaranteed by the National Bank of Poland, European Central Bank, governments or central banks of European Union Member States, OECD (with the exclusion of states which are, or were, restructuring their foreign debt in the last 5 years), and the State Treasury;
- > In the National Bank of Poland;
- > In cash.

In addition, receivables secured by mortgages established on buildings which are in construction phase may not in total exceed 10% of the overall value of mortgage-secured receivables in the cover pool. Within this limit, the receivables secured by mortgages on construction plots in compliance with the land use plan, may not exceed 10% (Article 23 of LZ Act).

The cover register for public covered bonds

A public bond is a registered or bearer security issued on the basis of receivables of a mortgage bank arising from:

- > Credits within the secured part with due interest, a guarantee or surety of the National Bank of Poland, the European Central Bank, governments or central banks of the EU Member States, the Organisation for Economic Cooperation and Development, except for states which are currently in the process of restructuring of restructured their foreign debts during the last 5 years, as well as a guarantee or surety of the State Treasury in accordance with provisions of separate laws; or

- > Credits granted to entities listed in the point above; or
- > Credits in the secured part with due interest, a guarantee or surety of local government units and credits granted to such local government units.

In regard to collateral location, mortgage collateral is restricted to mortgages against the right of perpetual usufruct or the right of ownership to a property situated in Poland are eligible for the cover. For public covered bonds, there is a wider scope and includes the following countries and institutions as eligible for the cover: National Bank of Poland, the European Central Bank, governments or central banks of the EU Member States, the OECD, except for states which are currently in the process of restructuring of restructured their foreign debts during the last 5 years, as well as a guarantee or surety of the State Treasury.

IV. VALUATION AND LTV CRITERIA

The mortgage lending value of real estate is determined under the LZ Act. The mortgage lending value of real property is determined prudently, with due diligence, on the basis of an expert opinion prepared by the mortgage bank or entities with appropriate real estate appraisal qualifications commissioned by the mortgage bank. The mortgage lending value cannot be higher than the market value of the real estate.

There are special banking supervisory regulations, which stipulate in details the assessment of the mortgage lending value and impose on the bank a duty to have a database for real estate prices.

The LTV limits are as follows:

- > Single Loan to Value of Security limit: not more than 100% of mortgage lending value (Art 13.2 LZ Act)
- > Value of Security limit, relating to the single loan: max. 60% of the mortgage lending value, to fund eligible assets (Art 14 LZ Act: *Funds raised from the issue of mortgage bonds may be used by a mortgage bank for refinancing mortgage-secured credits and purchased receivables of other banks arising from their mortgage-secured credits; the refinancing may not, however, exceed 60% of the mortgage lending value of the property*)
- > Absolute portfolio Loan to Value of Security limit: (Art 13.1 LZ Act: *The total amount of receivables from granting credits secured with the mortgages or purchased receivables of other banks arising from their mortgage-secured credits, in the part above 60% of the mortgage lending value of the property, may not exceed 30% of the total sum of the mortgage bank's receivables secured with mortgages*).

V. ASSET-LIABILITY MANAGEMENT

According to the article 18 of the LZ Act:

- > The total nominal value of all outstanding mortgage bonds shall not exceed the sum of nominal amounts of the bank's receivables secured with mortgages, which form the basis for the mortgage bond issue.
- > The bank's income from interest on its mortgage-secured receivables, referred to in the point above, may not be lower than the amount of the bank's payable interest on outstanding mortgage bonds.

The Act also ensures a suitable monitoring, according to the Article 25: A mortgage bank shall keep a mortgage cover account to ensure compliance, in the long term perspective, with the requirements referred above.

Additionally, according to the internal policy of each mortgage bank, the internal limits are set using management's experience in a development bank as reference.

VI. TRANSPARENCY

The information of the activity of the Polish mortgage banks can be found on the Polish Mortgage Credit Foundation's website: www.ehipoteka.pl.

The range of data published on a yearly basis includes: new issues of covered bonds, outstanding covered bonds (mortgage & public), total assets of mortgage banks and residential & commercial property credits' sale.

So far, none of the Polish issues has joined the Covered Bonds Label Initiative. At the present stage of CB market development, CB investors wouldn't acknowledge this step as an additional value above the detailed law driven requirements and structure of list zastawny.

Detailed information on the covered bonds issues can also be found on the issuers' websites:

mBank Hipoteczny: <http://mhipoteczny.pl/oferta/listy-zastawne/>

Pekao Bank Hipoteczny: <http://www.pekaobh.pl/u235/navi/31467>.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

According to the Article 31 LZ Act, the cover pool monitor (powiernik) maintains ongoing supervision of the management of the mortgage cover register.

The cover pool monitor should ensure that:

- > Commitments pertaining to the outstanding mortgage bonds are at all times covered by the mortgage bank in compliance with the provisions of LZ Act;
- > The mortgage lending value of the property adopted by the mortgage bank has been established in accordance with the regulations referred to in Article 22, paragraph 2; the cover pool monitor shall not be required to investigate whether the mortgage lending value of the property corresponds to its actual value;
- > The mortgage bank observes the limits laid down in Article 18 LZ Act; the cover pool monitor shall promptly inform the Banking Supervisory Commission of any cases of non-compliance by the mortgage bank with these limits.
- > The manner in which the mortgage bank keeps the mortgage cover register is in compliance with this Act;
- > The mortgage bank ensures appropriate cover for planned mortgage bond issues in accordance with the provisions of this Act, and proper control of appropriate entries in the mortgage cover register.

In order to perform tasks referred to in Article 30 LZ Act, the cover pool monitor shall have the right to inspect accounting books, registers and other bank documents at any time.

In matters not regulated by the LZ Act, supervision over mortgage banks shall be exercised in compliance with the Banking Law and the regulations on the National Bank of Poland (NBP). The NBP regularly checks the cover assets.

The Banking Supervisory Commission may commission an independent expert at the expense of the inspected mortgage bank to inspection of the appropriateness of the mortgage bank's entries to the mortgage cover register. This would also including establishing the mortgage lending value of the property was in compliance with the rules referred to in Article 22, paragraph 5 LZ Act.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

The Act of 28 February 2003 – Bankruptcy and Rehabilitation Law (Journal of Law no. 60 item 535) contains separate chapter: Chapter II - Bankruptcy proceedings for mortgage banks – Articles 442-450.

In case of bankruptcy of the mortgage Bank, the claims, rights and means referred to in Article 18.3 and 18.4 of LZ Act, recorded in the mortgage bonds cover register, shall constitute a separate bankruptcy estate, which shall serve in the first place to satisfy the claims of mortgage bond creditors; after satisfying the mortgage bonds creditors, the surplus of the assets of the separate estate shall be allocated to the bankruptcy estate.

In declaring the bankruptcy, the court appoints a curator (*kurator*) who represents the rights of covered bond holders in the bankruptcy proceedings. Before the appointment of the curator, the court seeks an opinion on the proposed curator of the Banking Supervisory Commission (Article 443.1. of the Bankruptcy and Rehabilitation Law).

The following order shall apply to the satisfaction from the separate bankruptcy estate:

- > The costs of liquidation of this estate, including also the remuneration of the curator,
- > The amounts due to the mortgage bonds per their nominal value,
- > Interest (coupons).

In case that the separate bankruptcy estate does not fully satisfy the mortgage bondholders, the remaining balance shall be satisfied from the whole bankruptcy estate funds; with that sum the curator shall vote when the arrangement is being adopted – according to Article 449 of the Bankruptcy and Rehabilitation Law: *If the separate estate is not sufficient for full satisfaction of covered bond holders, the remaining sum is satisfied from the distribution of the funds of the bankrupt estate; with this sum the curator votes in the signing of the arrangement; he has one vote for each sum resulting from dividing the sum of all other claims of those entitled to vote by the number of creditors representing these claims. The sum earmarked for the satisfaction of covered bond holders is moved from the funds of the bankrupt estate fund to the funds of the separate bankrupt estate.*

In that case, the additional amount for satisfying the mortgage bondholders shall be transferred from the bankruptcy estate funds to the separate bankruptcy estate funds. It means that the covered bond holders get preference over other creditors.

According to the Article 446 Bankruptcy Act – The declaration of bankruptcy of a mortgage bank does not infringe maturity dates of its obligations towards covered bond holders. It means that the covered bonds do not accelerate.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

In order to apply a preferential risk-weighting for covered bonds, the instrument needs to meet the criteria of UCITS Directive and the Capital Requirements Regulation (CRR).

Polish covered bonds (*list zastawny*) already fulfil the criteria of UCITS 52(4) - in December 2008, the Polish list *zastawny* was notified by the European Commission as an European “eligible bond” – i.e. covered bond – the instrument with a qualified collateral. In that way, the notification procedure, applied by the Polish Ministry of Finance, was finished. Polish *list zastawny* can be found on the EC’s website.

The covered bond (*list zastawny*) falls also within the criteria of Article 129(1) CRR.¹

The new requirement of LTV limit – it is fulfilled by the Polish law - see Article 14 of the Covered Bond Act:

“Funds raised from the issue of mortgage bonds may be used by a mortgage bank for refinancing mortgage-secured credits and purchased receivables of other banks arising from their mortgage-secured credits; the refinancing may not, however, exceed 60% of the mortgage lending value of the property.” The limit of 60% is used for every single loan and the limit is even more restrictive than the one allowed for covered bonds by the art. 129 (1)(e) CRR (which is 80%).

The previously binding CRD requirements were word-for-word implemented by the Polish Financial Supervision Authority – see Resolution 307/2012. Therefore it is to assume that the Polish covered bonds (*listy zastawne*) apply for the preferential treatment.

¹ Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): <http://ecbc.hypo.org/Content/default.asp?PageID=504#position>.

Moreover, National Central Bank added covered bonds (*listy zastawne*) to the list of instruments eligible for pawn credit / repo transactions. As of July 2013, the haircut level for repo amounts to 15,0 (3M repo); 20,0 (6 M repo); 25,0 (pawn credit) – ave. maturity of covered bonds – 5 years.

In Poland, the investment regulations pertaining to the limits for covered bonds are as follows:

- > Banks – no limits;
- > Insurance companies – up to 40% of technical-insurance reserves – insurance companies (10% in covered bonds which were not allowed to public trading);
- > Investment funds – open: 25% of the assets may be invested in covered bonds issued by one mortgage bank; but: total investments in covered bonds may not exceed 80% of the fund's assets and total value of investments in securities or in monetary market instruments, issued by the same mortgage bank, deposits in that entity, as well as the total value of risk connected with the transactions on non-standardised derivatives, which were dealt with that bank, can't exceed 35% of the fund's assets;
- > Pension funds up to 40% of the total asset value, 10% per one issuer;
- > Only the specialised mortgage banks are entitled to the issue of the *list zastawny* (the Polish covered bond). The current *list zastawny* issuers are: mBank Hipoteczny S.A., and Pekao Bank Hipoteczny S.A.

> FIGURE 1: COVERED BONDS OUTSTANDING, 2004-2013, EUR M



Source: EMF/ECBC

> FIGURE 2: COVERED BONDS ISSUANCE, 2004-2013, EUR M



Source: EMF/ECBC

Issuers: Pekao Bank Hipoteczny S.A. and mBank Hipoteczny S.A.

ECBC Covered Bond Comparative Database: http://ecbc.eu/framework/77/Polish_Covered_Bonds