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MODERATOR: MS FREDERIQUE DAHAN

THE MODERATOR: Welcome to the Legal Panel on strengthening mortgage markets. I am Frederique Dahan, a Senior Counsel in the Legal Department in the Office of the General Counsel at the EBRD, based in headquarters. I have been working in the Legal Transition team within the OGC for several years, where I lead the legal reform projects that EBRD undertakes to provide technical assistance to assist countries reforming the legal and institutional framework on secured transactions; security interest, both pledges and mortgages.

I am very pleased that we are meeting today. There is a very prestigious panel of experts, who have kindly agreed to take time out of their busy schedules to speak to you about their experience on mortgage markets from the legal point of view. I can reassure you that we are not all lawyers; it is a mixture of lawyers, a banker and an economist, so it should not be too dry for the non-lawyers among you.

We have divided the panel into four mini-panels, which will all last twenty minutes or so, on different themes. After a brief presentation from each of the panellists we will open the floor for questions and answers. Again, I will have to be very strict with timing in order not to run into the next mini-panel. The intention behind this format is to encourage your direct participation and have more of a dialogue rather than a one-way presentation. We will start with a general introduction on the importance of a strong legal infrastructure for mortgage markets, and then we will move to three large markets in the region that are at different stages, starting with Ukraine, Romania and Russia. We will look at their strengths and weaknesses and examine their prospects against the backdrop of the institutions and the laws underpinning them.

On my left is Arthur Iliev, who is a partner at Clifford Chance CIS Limited, based in Moscow. Arthur has headed the capital markets practice for the last seven years. Arthur has wide experience and expertise on all sorts of capital markets issues such as IPO debt, offerings, and securitisation transactions. There is a full biography outside if you want more details on his extremely impressive career.

Andrei Burz-Pinzaru is a Senior Manager with Reff & Associates, which is the correspondent law firm of Deloitte, Romania. Before joining Deloitte, Andrei worked as a capital market and finance expert in a number of organisations, and he is

probably the most widely recognised expert on Romanian mortgage lending law, mortgage bonds and mortgage-backed securities in Romania, so we are very glad indeed that he has taken the trouble to speak on the panel.

Angela Prigozhina, on my right-hand side, is Head of Corporate Communications and Research for Raiffeisen Bank Aval in Kiev. She has over fifteen years of professional experience in banking and development finance. Angela has a very interesting mixture of private banking and development work with the World Bank. It makes her truly unique in her understanding of the way in which mortgage markets operate, and with the larger picture of financial sector development.

Finally, Rory Spain is a partner at the progressive Banking Solutions Ltd., Dublin. Rory is a banker with extensive experience in banking/operational/management with a special emphasis on mortgage lending. What is particularly noteworthy for us is that Rory was one of the lead consultants on the minimum standards for mortgage lending that EBRD has developed and implemented since 2004. These standards accompany all our mortgage credit lines in the region as the minimum standards that are to be adopted by our partner banks.

I will begin with a short introduction by saying something that is very close to my heart. EBRD does support efficient mortgage loans. It has a development mandate. It is fostering the transition to the market economy, and it sees the development of laws and institution as the backbone for this development to take place.

In order to provide technical assistance that is focused and truly additional, EBRD embarked two years ago on a project reviewing, assessing and analysing mortgage loan development in the region; and these are the findings. Some of the recommendations are published in this publication, but it is available to you outside and on the publication desk in the main building.

Some of the findings of the research were that an efficient mortgage legal framework is within the reach of transition economies. We found that the mortgage laws that were developed over the last ten years or less in many respects incorporate the best practices that allow mortgage markets to develop from a primary mortgage market to

a secondary mortgage market. However, we have also found a number of weaknesses or inefficiencies that we think should be tackled for these markets to be truly efficient. We think that it is important that all legal reforms are underpinned by the economic rationale of mortgage markets. For this, we have submitted basic criteria for efficiency of mortgage loans.

Something simple, which is often missed, is that mortgage loans are there to serve economic and social purposes, serving society's needs. Mortgage loans should fulfil the basic legal function of assigning a piece of property, be it a flat, a building or a piece of land, to guarantee payment of a debt, a loan or any form of credit. It is this collateral aspect that gives mortgage loans so much value. What makes mortgage lending a very sound business is because there is property attached to it, but the way it is attached to it, and the way the right of mortgagees can be enforced depends on how efficient the underpinning laws are.

The second part is how the law allows economic benefits to be maximised. This is how we consider that mortgage law should stand, and what we encourage the countries to focus on.

Without further ado, I will give the floor to Rory, who will give his personal banking experience on the importance of a strong legal infrastructure.

MR SPAIN: I am going to talk in general about mortgages. There are four topics I want to cover in a very short presentation. I want to talk about the fundamentals of mortgage lending. This is topical just now with the massive losses on the sub-prime market across the Western world. I will then talk for a few moments about the vision and direction the EU is taking in relation to mortgage lending.

The third area I want to talk about is the development of sound mortgage laws, and finally I want to talk about what happens if things go wrong and there is a need for closure, and the legal issues that might arise around that.

Let me start with the fundamentals of mortgage lending. As you can see from the slide, it is very, very simple; there is no rocket science, no magic; it is common sense.

It is about the ability to repay, supported by realisable collateral. Over the last five to ten years some banks have lost sight of these fundamentals in the race to get more market share and an even greater return on investments. Banks have not carried out the proper professional type of analysis that is required on any mortgage application. Let me emphasise again that ability to repay is what it is all about.

In establishing that ability a lender needs to stress-test the current situation; stress-test the interest rates, the customer's income and also the loan-to-value ratios, and to do effective analysis that asks: in a changed situation will this person still be able to pay back this loan?

As you can see, there is a need for security and getting proper realisable collateral. It is very important when it comes second to the ability to repay. If a lender lends on the first day on the basis that they are going to have to realise the collateral, it is going to end in tears for everyone. The lender will lose and the customer will lose; and society will lose. The basic premise is ability to repay, supported by realisable collateral if things go wrong.

In this context, having good mortgage laws will never ever compensate for bad lending practices; but that is just a little global pitch on the need for good common sense in mortgage lending.

I want to move on to talk about what is happening within the EU. Last December the EU issued a White Paper on mortgage lending entitled *Integration of Mortgage Markets*. This followed on from substantial research and consultation over previous years. The key aspect of this is cross-border lending. Let me just paint a picture for you. This is a vision: there are many barriers, including legal barriers and consumer protection law and other types of barriers.

Here is a picture of a mortgage applicant in Riga who could apply to a bank in Bucharest to buy a property in Paris. It sounds pretty impossible but it is not. The whole idea is one market. There should be open transparent markets. That is the objective, and, as I said, there will be many barriers to be overcome along the way to reach that objective. There are three areas within this paper that I want to bring to

your attention. The first one is responsible lending. This will reinforce what I said in the first slide: the terminology used is “rigorous and adequate assessment of the applications”. That is the direction the EU is taking to lenders within the EU: “You must carry out rigorous and adequate assessment of the applicant’s ability to repay.”

“Cross-border credit data would be used if available.” The objective here also is that at the applicant’s request the financial institution would provide advice, but this advice must be objective, professional and specific to that individual. In other words, a detailed fact-finding process is required, so as no vanilla mortgage product is handed out the mortgagor. What is recommended to a customer has to be specific to their needs.

Let me talk for a moment about pre-contractual information and consumer education. That is part of the same change that is proposed. Currently within the EU there is a pre-contractual document in use called ESIS, (the European Standard Information Sheet). This is a pre-contractual piece of data that should be given to every applicant. It should be standardised, because currently it is not. Here is the type of information it would hold: the amount of the loan, the monthly repayments, the interest rate applied, the total cost of the credit, the security to be taken for the loan and so on and so on.

Currently the standards are not being adhered to, and the objective is to totally standardise this across the EU so that mortgage applicants can very easily compare offers being given to them by different financial institutions.

I want to talk about valuations at the Land Registry and foreclosure. There is an objective that valuations or property appraisals will be cross-border eventually; also that the standards right across the EU would be totally reliable. Within the cadastre there is currently a project in place called EULIS, which is on-line data. I am from Ireland, and our country is one of the countries using this.

The objective is that a mortgage applicant or a financial institution or indeed anyone who has a right of access can access a Land Registry cadastre in any country and get standard information.

Finally, let me talk about foreclosure. The last slide will also be about this. It should be quick, cheap, efficient, and the maximum value possible close to market value should be achieved for the property. That is just a thumbnail sketch of the plans that are afoot in the EU.

Let me talk about developing a sound legal framework. You may not be able to read the detail of this, but down at the bottom with bullet points it outlines a list of the type of provisions that would be in a good mortgage law. Let me talk about the difference between a common law jurisdiction and a civil law jurisdiction. I come from a common law jurisdiction. We do not have a mortgage law for primary mortgage lending. We work on the basis of banking law and case law, and it works pretty well. Of course, there are laws for the secondary market for the issue of mortgage-backed securities and mortgage bonds.

Many of the countries that use civil law feel that it is necessary to have a specific mortgage law, and I can understand why. Many of the provisions of the civil code and the pledged law become incorporated into mortgage law. It is very important in the development of a mortgage law that there is wide consultation with all the possible stakeholders and users of that law, from financial institutions to estate agencies, to lawyers, to notaries and so on, including members of the public. The reason for this is that in order to have a good law that will ensure buy-in to the ultimate law that is passed, there is a need for wide consultation.

Let me for a moment run through a number of the areas that would be covered in a good mortgage law. What is a mortgage; when and how can it be established; what type of assets can be mortgaged; whether valuation and appraisal of the property should be included in the mortgage law; the mortgage contract itself; the rights and obligations of the borrower and the lender; the registration of the mortgage in the cadastre against the property; insurances, specifically property insurance but also other types of insurances; the assignment of the mortgage to a third party in the event of an issue of bonds or mortgage-backed security; what happens in enforcement; and mortgage over present and future buildings; and what about buildings in the course of

construction? In addition, there would be a piece on consumer protection and also a piece on who is going to regulate mortgage lenders.

That gives you a good idea of the type of areas that would be covered in a mortgage law.

Finally, I want to talk about what happens when things go wrong. As I said at the beginning, it is all about ability to repay. Of course things change. The circumstances of a customer today versus the circumstances of a customer in five years' time can be totally different. No-one can see round corners, so what happens when things go wrong? The most important thing here is that a lender has a legal right to enforce repayment of the mortgage and go for foreclosure if necessary.

It is interesting to think about how courts may view a mortgage lender who is trying to take possession of a property. In my part of the world, banks had better not get it wrong. A bank needs to have everything 100 per cent correct and would get no sympathy whatever from a court if they made mistakes.

Equally, particularly where there is a young family and a spouse in a property, if in the new and straitened circumstances the debtor finds himself they are making every effort within those circumstances to repay the mortgage, a judge would be very slow to give a financial institution possession of the property.

That gives you an idea of how things are viewed in different jurisdictions. At the end of that slide there is a little piece that says: "What are the typical types of issues that might arise in the move to foreclosure? Give us some ideas of what can happen." The existence of the mortgage itself could be challenged. The event of default could be challenged to and the notice given to the mortgagor in terms of the foreclosure, the publicising of that notice. How is the property going to be sold? Is it going to be sold by public auction or by private treaty? Who will exercise that sale?

I will leave this slide up for a moment. This is a slide that is taken from the publication that many of you have a copy of that talks about the area of foreclosure and how, let us say, efficient it is. There are three lines on this: red, blue and pink.

There are 16 countries across the base of the slide, including some EU countries and non-EU countries. The red line is about speed of enforcement - and if that is high it is good. The blue line is about the price that the property has been sold for. If that is high, it is good. The last line is the pink line ... enforcement, and if that is low, it is good.

I am happy to take questions. Thank you very much for listening.

THE MODERATOR: Thank you very much, Rory; that was a very nice and neat journey through the importance of the legal framework and what it contains. Are there any questions at this stage?

I will ask the first one, which is always the hardest - because then the questions flow. You make a point about the need for consultation around the process of drafting a mortgage law and having it passed. What has been your experience in similar countries where you have worked on this consultation process?

MR SPAIN: I am working on the development of a mortgage law in one of the countries close to Ukraine. We engaged in very wide consultation with probably too many people, but it was very, very wide. It included all the government agencies, the lenders, the notaries, the insurers, the valuers, and the property developers. We tried to assess from the public what type of law they would feel was the right type of law for the country. We feel that that type of research opens up interest in the topic but also enables the developers of the law plus the country itself to get the right type of law for the country in question.

MR BURZ-PINZARU: I would like to add a few words about our experience in Romania. The initial mortgage lending law that was passed in 1999 was done with barely any consultation, and it turned out that it did not properly address numerous practicalities. In 2005 a mortgage task force started to work on the re-drafting of the mortgage lending law, and drafting of a mortgage bond law and a securitisation law. That was a model of how a task force should work because it involved the players. You mentioned that perhaps too many estate agencies are involved, but we only had involvement by key stakeholders: the central bank, the Securities Commission,

because we were discussing securitisation; lenders, law firms, and the Ministry of Finance. It was particularly useful to discuss it with the lenders because they face the problems in dealing with mortgage lending law, and the input from the lenders side is essential, in my view.

A PARTICIPANT: I was interested to hear two possibly unrelated points that Rory was making. The first was when you outlined this seemingly impossible vision of borrowing from one country, getting finance from another and having it secured against a property in a third country. Then you gave the example of Ireland where it is very important to get things right because the natural sympathy of the enforcement authorities, the courts in this case, would try and find in favour of the debtor if they could.

Does that say something about the difficulty unless you are realising what you call this potentially impossible dream? If you are based in Latvia and borrowing money in the Czech Republic, and securing your debt against property in Portugal, when it comes to enforcing your rights in Portugal, is it not natural that the Portuguese courts will apply their values and preferences? They will be much more naturally aligned to the unfortunate debtor in Portugal; so is it possible to realise this dream in isolation; or do you have to have a consistency of approach among the enforcement authorities as well?

MR SPAIN: The most important thing in relation to the White Paper is that this is a vision, a direction, that the EU wants to take. It is a common market across all products and services. I did say that there are barriers, and there are many barriers at present. I suspect it would take some time to achieve such a vision because there are different laws in different countries. One of the hallmarks of the White Paper is that no country will be asked to develop a common pan-European law; each country will have its own law. It is certainly a challenge. It is a vision, it is a dream; and I do not think it will be achievable in the short term, but the objective is to make it happen.

A PARTICIPANT: I am another hapless lawyer in the room. My question for Rory, looking at mortgages and in particular those two aspects of ability to repay and realisability of the collateral, is this: is there not another factor at work here, and that

is the lender who prices for risk, who looks at the borrower's ability to repay and prices the interest rate on the mortgage and the loan-to-value according to that borrower's ability to repay; but if there is an over concentration on the ability to repay, are you not then taking away the lender's rights to price for risk accordingly?

MR SPAIN: Of course, I was focusing on the fundamentals. To do an adequate credit assessment of any mortgage application covers a wide variety of boxes, which all obviously need to be ticked, and I absolutely agree with you.

THE MODERATOR: I will now give the floor to Angela who will say a few words on the Ukrainian mortgage market.

MS PRIGOZHINA: I am deeply honoured to speak today on the panel. I welcome everybody to the beautiful city of Kiev. It is an ancient city with a great history; but those who were here ten years ago have probably noticed a big difference. There are many new construction sites and renovated buildings. This is definitely evidence of a growing economy, or a transition economy, but it is also evidence of steady foreign direct investments and a rapidly-developing mortgage finance market in Ukraine. If you look at what has happened in Ukraine over the last four years, and based on what Rory has said, Ukraine can be both a good case study in terms of what has happened - why the phenomenon of the mortgage market in Ukraine has appeared after 14 years of dormant activity in the banking sector, when all the international observers have been waiting to see when Ukraine would have a vibrant banking sector and when mortgage lending would be kicked off.

Suddenly, in 2004 we saw a jump start in mortgage financing, which has led us to an almost 15 times increase of growth of mortgage portfolio on the books of the banks in just four years, from nearly zero per cent of GDP at the end of 2003 to nearly 8 per cent of GDP today, which is compatible with the situation in Poland, the Czech Republic and Hungary, where the figure is also around 8 to 10 per cent.

Ukraine has achieved such a track record in just four years. What has happened? Why did banks suddenly become interested in mortgage financing, and what has driven such a great demand for mortgage lending in Ukraine?

I would like to mention the key growth drivers that have resulted in rapid development of the mortgage market. I would divide this into two groups: the first group is definitely demand the opportunities that exist in the market. As I mentioned, the market has been dormant for long periods of time, so this has been an accumulation of demand and interest in mortgage financing in the country. Secondly, and not the least important side, is the enabling environment that has been established to provide market financing in the country. Ukraine is a civil law country that has a very strict rule of not doing anything that is not allowed in the legislation. There is simply no law in regard to mortgages - it means you cannot do mortgage lending in this country because it is not allowed and is prohibited: this is the legal mentality and perception in this country.

Therefore, in order to do mortgages, mortgage legislation of adequate quality has to be established. As in Romania, we have already tested for a period various banking legislation - because at some point in time you pass a standard piece of legislation, which may not always work, so you have to learn the practices of your own country as well as best lessons and best practices from other countries in order to enact something that works. I am personally very confident that in Ukraine we have definitely learned the lessons of other countries.

The first factor is the market and growing demand. In Ukraine, you may have heard that historically many people ended up owning their own apartments. These are mainly condominium apartments, and during the early stages of the independence of Ukraine many people got hold of these apartments and privatised them. However, the living conditions in the apartments were not adequate. An average Ukrainian has 22 square metres per person, while the average in central and Eastern European countries is around 35-40 square metres per person. That created demand especially from younger or wealthy families to improve their living conditions, and they were looking for opportunities to borrow to buy new apartments at a greater price.

The second major driver for the growing financing market was the absence of any alternative finance, and everybody was looking at real estate as the only alternative; if you wanted to invest in real estate, you also had to develop and enhance the quality of

real estate to increase the return. Also, for the last four years Ukrainian income has been growing, and with a growing nominal income many Ukrainians have been able to afford better housing and a better quality of life. From the point of view of either local or international investment, with rapid growth of house prices in Ukraine - and we have observed a record growth in prices in Kiev and larger cities in Ukraine. In just 2005 and 2006 prices in Kiev grew by 65 per cent per annum on average. Last year, in 2007, the price increase was just 14 per cent which is evidence of a certain situation in the market, and the market is cooling down; but in the first quarter of 2008 we have already seen a 15 per cent growth in house prices.

Another reason why mortgage financing became very attractive was because generally real estate and infrastructure has been significantly under-developed because we lacked foreign direct investment. Once Ukraine became more attractive to investors, there was a major inflow of capital, as well as remittances in the six largest regions of Ukraine that are more industrially developed. If investors come there and businesses develop, you would expect people to live in better conditions. Six major cities have shown dramatic growth both in housing prices and in absorption of mortgage loans. Apart from Kiev, this applies to Odessa, Kharkiv, Dnipropetrovsk, Donetsk and the Crimea region, which are the most attractive cities in Ukraine.

From the point of view of the enabling environment, which is the second, but not least important factor, the creation of proper legislation has been the major trigger for a booming financial market and the increasing appetite of commercial banks in Ukraine to enter the market.

In 2003 Ukraine passed a number of acts that created an almost complete legal framework for primary and secondary mortgage financing in the country. First, a law on mortgages was passed and then Ukraine passed a law on mortgage securities. In addition to other laws that are either operating already or which have been revised to adjust to mortgage law, for example loan pledges, law on encumbrances and protection of creditors' rights, a land court and a law on appraisal of real estate assets. All these legal acts have completed the formation of the necessary - perhaps not

comprehensive but sufficient legal framework - to do mortgage lending in the country.

In addition to the legal framework Ukrainians have started looking at infrastructure. Most important are registration, intermediation and security. From the registration point of view Ukraine has had a pledging registry, and on the basis of the law on encumbrances Ukraine is also in the process of establishing a register of encumbrances for movable property, which is essential for pushing the securitisation process in the country.

Following passage of the law on mortgages, there were passed special by-laws on establishing a mortgage registry at the same place where pledge registration and registration of encumbrances was operating in the Ministry of Justice.

In addition to infrastructure, Ukraine has, in parallel, after the creation of the Ukrainian National Mortgage Association, developed standards. It was a combined effort of many donors, often led by the World Bank and supported by the IFC and EBRD. Ukraine has developed three parallel sets of standards: EBRD standards, IFC standards and standards for mortgage lending of the National Association, which were very compatible and basically the same standards. There was a high level of understanding and comfort that the largest international and local lender community were agreed on the basic principles of the game.

In addition to the National Mortgage Association, which became the pioneer of market development, recommending uniform standards during promotion and capacity-building, the government has tried to establish a second tier mechanism for provision of liquidity from mortgage originators. A state mortgage institution was also established in the middle of 2004.

This is a prototype of the Kazakhstan Mortgage Institution. However, today it is still not very active even though it does provide financing to Ukrainian banks. I have touched on other aspects, constraints, because the liquidity of this market, and this refinancing is not sufficient.

It is very important that all the associations and existing market players, including real estate agencies and associations and bankers have all combined efforts to conduct a series of seminars in order to make the market aware of what a mortgage is, how to originate mortgages. There have been many sessions and discussions with different NGOs and public organisations as to what eviction means. I recall that we had a round table in the parliament of Ukraine until the law on mortgage was passed allowing the eviction from an apartment from real estate. There was an established belief in the country that as long as you evict somebody - poor people and families - the social notion was not to accept any kind of eviction, which would definitely prevent the development of the mortgage market. We have discussed what is more important: to allow a big group of people to improve their living conditions; or find a mechanism to provide social housing for a fraction of the population that would need social support. Therefore in the law on mortgages there is a special provision that you can evict, but if you evict and a person cannot (break in tape recording) ... is another issue which I will quickly elaborate on.

When it comes to constraint, the picture would be too pink if I did not mention the constraints in the market. While there was a wonderful task force and a group of leading bankers and politicians all interested in the development of the mortgage market, we also had some legacies of the past. At the moment Ukraine has a secondary legislation, if I may say so, which has been passed on the initiative of one of the bankers in the country. This law, to some extent, is a repetition of the standard loan mortgage and the law on market securities. On the other hand, they have a different interpretation of terminologies and may use some different vehicles for issuance of securities.

Despite all the efforts to put a ban or veto, or abrogate this law, we have not been able to succeed in this effort, and therefore Ukraine has two legal sets of acts. At the same time, all the investors and bankers are using the officially recognised - and I believe - internationally acceptable and compatible law on mortgage and loan mortgage securities, which provide the official formal legal ground for mortgage lenders to lend. In addition to these laws, we have another problem, which is definitely in the depths of one of the legal acts. This is a law on a special mechanism for housing construction that allows non-conventional mortgage financing for unfinished

construction. This not only creates an exacerbated risk for the investors - in many cases individuals who basically take 100 per cent of the risk during the construction process - but it also creates a very gloomy picture for conventional mortgages because over the last two years there have been several scandals, where some construction companies have failed to deliver the housing to individual investors. This has definitely had a negative impact on the reputation of good mortgage lenders who provide direct financing for completed apartments and construction in the secondary market.

I will briefly mention other constraints, which are challenges to address. They are the absence of a uniform land registry and real estate, which should be combined. We have had lengthy dialogues with different agencies in the country, and still we do not have a single electronic land registry. This prevents abrogation of the moratorium on land in Ukraine. As you may have heard, for several years we have extended the moratorium on land, and one of the key reasons for this is that Ukraine first has to adopt special legislation and make it effective on registration of land, on appraisal of land and on creation of a single registry. Until this is done, probably the members of the Ukrainian Parliament will not allow the lifting of the moratorium.

There are some risks related to activities of the financial sector, and one of the major risks that may in the future hamper smooth development of the mortgage market, is maturities mismatches and absence of long-term finance. This is more related to development of the domestic capital markets because at the moment despite the international liquidity crunch Ukraine has not been significantly affected by the international liquidity situation, and at the moment we have an abundance of dollar-denominated funds. Ukraine has a local currency liquidity squeeze at the moment, partially created by the growing demand and notion of Ukrainian banks and the desire to lend in local currency as well as the tightening regulatory requirements by the National Bank of Ukraine in the light of accelerating inflation, as well as the response to the international liquidity squeeze where the National Bank decided to take some measures to make banking, lending and the general soundness of the banking sector better, together with increased prudence in regard to mortgage lending in Ukraine.

THE MODERATOR: Thank you very much. That was very informative, and pinky but not too pinky, which is fair!

Unless anyone has a burning question now on Ukraine, we will turn to Andrei, who will give us an over-view of the Romanian market. What is fascinating about the Romanian market is the process moving towards a secondary mortgage market. There is no better person to talk about this than Andrei!

MR BURZ-PINZARU: Thank you for the introduction. The topic there is: “Where is Romania in the reform process?” I am not going to speak about the general reform process, but I will focus on the mortgage market legislation.

In 2004 I came to work in a mortgage task force, which aimed to create the prerequisites for securitisation and mortgage bond legislation, and on the other hand to address some outstanding issues that the originators had identified in relation to the mortgage lending law. In 1999 a mortgage lending law was passed in Romania, but it is fair to say - continuing from Rory’s introduction about mortgage lending law in general - that in Romania as well as other civil law jurisdictions you should not look at a mortgage lending law that regulates everything about mortgage loans or mortgages in general, because those are mainly regulated in the civil code. I do not see the point of trying to have one piece of legislation aiming to regulate everything.

In Romania we have a mortgage lending legislation package, which includes a mortgage lending law, a mortgage bonds law, a securitisation law and a mortgage bank law. In subsidiary you would have various regulations issued by the Romanian Securities Commission and the Central Bank of Romania.

Currently the legislation is in place, both for origination of mortgage loans as well as transfer of mortgage portfolios and securitisation and mortgage bonds. They are regulated in some detail - some people would say perhaps in too much detail, whether in regard to origination or securitisation. However, legislation and regulation is in place. If we talk about the secondary mortgage market it is about somebody coming and doing a deal - and here the economics play a role. My assessment is that without the international financial crisis there would have been a securitisation transaction this

year in Romania. To my knowledge, currently several financial institutions are looking at structuring one or another form of refinancing. However, what has been so far has just been warehousing and transfer of mortgage portfolios to other companies.

The Romanian tax framework still needs to address some aspects. I am not referring to VAT, which is one of the standard questions when it comes to transfer of portfolios. There is no VAT on transfer of portfolios in Romania. I am referring to the so-called tax neutrality of the special purpose vehicle, talking about securitisation; and that is one matter that is referred to in the securitisation law but which is not really addressed from a tax legislation perspective.

Perhaps things should have been done in a certain way, and maybe some mistakes could have been avoided. When the first mortgage lending law was passed in 1999, whoever drafted that piece of legislation I would say aimed too high; they basically created a law that was supposed to regulate but which did not regulate in a proper manner - origination of mortgage loans, transfer of mortgage portfolios, securitisation and mortgage bonds - everything in a few pages of legislation. Concepts like securitisation and mortgage bonds did not even exist in the Romanian dictionary and were totally foreign even for the professionals. Therefore, that part of the legislation (i.e. referring to secondary mortgage market) remained totally unutilised. When law firms were asked to give a legal opinion about issuing mortgage bonds in Romania, they would say: "Yes, we have a law that says you can, but we cannot really tell you what that means under Romanian law because we have no clue about that." The same applied to securitisation of mortgages.

That is definitely one thing that should have been avoided - aiming to regulate too much. I think that the way things are regulated currently is better in the sense that it separated the regulation of origination of mortgage loans; it separated from securitisation and also from mortgage bonds. That is a good way to address things. One should aim for consistency because at least under Romanian law, mortgage bond legislation has some cross-referral to the securitisation legislation, so one should be very careful to ensure that they are consistent.

Another thing that would have been useful to have been done in 1999, when the initial mortgage lending law was passed, was to do what was done several years later in 2004 and 2005, that is: to consult with the market. It is also fair to say that in 1999 the experience of the originators was not that great; however, what we did in the mortgage task force in 2004 and 2005 was to consult with the key stakeholders. The most relevant feedback came from the lenders, and they are the first to be consulted whenever an international organisation aims to sponsor a legislative development, because you do not want to end up with legislation that does not address the concrete matters. In addition, you do not want to create a piece of legislation that cannot be implemented because of lack of sufficient detail on the level of implementation.

Yesterday evening we had a bit of a discussion, perhaps a dispute, about whether the mortgage lending law was useful at all to development of the mortgage market. Here, I would say that I believe it has been useful, and it has been useful because it introduced at least the framework for some standards of mortgage origination. Due to the mortgage lending law, mortgage loan agreements have certain things in common in Romania, which is good in terms of market practice, and it definitely creates good premises for securitisation. From that perspective it was a good thing.

However, I do not believe that the mortgage lending law was the trigger for mortgage lending; I believe it would have developed anyway. Banks were providing loans which, in their view, were governed only by the banking law and the civil code, which creates a bit of a problem because, as is quite obvious, you cannot decide contractually whether a certain law applies to you or not in this respect. To the extent that a loan falls under the definition of a mortgage loan in mortgage loan law, it is governed by that law whether we like it or not. However, there were banks that provided loans and they even stated that the contracts were governed by the civil code and the banking law; and invariably they did not have to observe the requirements in the mortgage lending law. One of the more annoying aspects related to having to inform the borrower ten days in advance of the terms of the contract, and banks perhaps ignored that type of legal request.

The law applies anyway; but, second, when banks try to securitise, depending on the inconsistencies with the law, they might have a bit of a problem because under the

securitisation law you can only securitise those assets that were originated in full compliance with the law. When asking for a legal opinion about whether those assets are securitisable, there might be a bit of a discussion, depending to what extent there are differences between their origination standards and what the mortgage lending law provided.

If I was asked about the key problems in the Romanian mortgage market, I would rather refer to the commercial mortgage lending - construction/development. The problem there does not come from the mortgage lending law but from the property regime in Romania. As you know, fifty years ago Romania was subject to nationalisation. There are still many law-suits and claims in relation to property. When a bank finances a construction development it would have to take a legal opinion on the property title; and giving those legal opinions is not very easy; you could have difficulty in accessing the documents. You could also have difficulties in assessing the risk because on the one hand we have special restitution laws, and there are people who claim under those laws and there is a statute of limitation, which expired. However, you could still claim ownership under the civil code anyway. There is no provision saying that if you have not claimed it under the special restitution law, you cannot claim it under the civil code general rules.

We hope that this will be clarified. The Supreme Court was asked several months ago to issue an opinion in order to secure consistency between the interpretation of various inferior courts in Romania and those who did not file a claim under special restitution could still file one, and we hope that they will take a firm position, which would definitely improve some of the issues.

If I were asked to say what would be a trigger for bank lending in Romania, I would say that legal due diligence on the title is a key issue because you can have a very nice mortgage contract running to twenty or thirty pages, but if the borrower does not have a proper title on the property and lost the title, they would also lose the mortgage. That is, in my view, currently the biggest area of concern.

THE MODERATOR: That links with Angela's final point about the need in Ukraine to revamp the title register and the cadastre. It is an issue in many countries.

We have five minutes to take some questions.

A PARTICIPANT: I should like to take the opportunity of asking you a practical question - perhaps spying on colleagues, since you represent different traditions! I would ask each of you to share a few practical ideas for a workable solution in your jurisdictions to use a car loan portfolio to attract additional financing and use this as a collateral in order to secure additional financing for a local bank in your jurisdiction, the provider of finance being a foreign financial lender: would this work in your respective jurisdictions?

MR BURZ-PINZARU: I am working currently on a transaction where one of our client's banks is providing financing. I do not know what type of financial entity you are talking about, but in the case mentioned we talk about providing financing to a leasing company in Romania. That financing is partially based on existing portfolios, but in the end it will be used for future car loans. We have structured the collateral in a manner that is comfortable to deal with from a balanced perspective. I am not sure what particular issues you foresee, but in Romania in such a transaction we use the movable collateral law, which regulates pledges. We would aim to identify as far as possible the assets that will be governed by those pledges. It is helpful that the movable collateral law in Romania provides for creating a pledge on a pool of assets, provided that you properly describe that pool, but without necessarily identifying each of them. That would be better addressed under securitisation law, but without that, under the general principles of the movable collateral law you can deal with that. We would also do some due diligence on the documentation that the company which receives finance is using in relation to its clients, because ultimately the comfort of the bank comes from the ability to follow up those assigned debtors; and that depends on the solidity of the underlying leading documentation.

MS PRIGOZHINA: Ukraine has established its collateral for movable property exactly on the replica of the Romanian registry. We have worked extensively with our Romanian colleagues. On securitisation of car loans about a week ago one of the largest banks of Ukraine has just issued the portfolio of securities for car loans. It was the first bank a year ago to issue first securitisation, mortgage-backed securities for

mortgages, and they surprised the market by doing the same for car loans. It is feasible. Not everything is going smoothly, and in Ukraine there is now a draft law on amendments to the law on mortgage bonds, which will smooth out some of the areas in the legislation which give difficulties sometimes - but it works.

A PARTICIPANT: Are you talking from a lender's perspective or from a borrower's perspective? If you speak from a lender's perspective, I would definitely recommend that you also try to control the bank accounts, where the borrower would collect the money from the lease agreements in the case of leasing, or from the loan, if we are talking about car loans. The lender would want to ensure they are able to monitor the cash flow that enters into those bank accounts.

MR ILIEV: I do not know if I correctly understood. In Russia we use different techniques. In leasing and leasing securitisation you assign the object of the lease. Basically, you sell it to the foreign SPV which has a Russian branch. It is done for VAT purposes. The leasing companies will sell the cars to the Luxembourg SPV and the Luxembourg SPV will then issue the notes to finance this purchase. That is one way.

On the other loan side it is also the cross-border securitisation - the way you finance it is that the Russian bank would assign the other loans to the Luxembourg or Netherlands SPV and then if, for example, the assets are expiring then you do a rolling structure; you continue to sell the other loans to the Luxembourg SPV, and when they are redeemed the SPV uses money to buy further other loans. There are various techniques for doing this in Russia.

THE MODERATOR: Arthur, this is your turn.

MR ILIEV: I am looking at mortgages and mortgage legislation from the capital markets perspective, but in any event I will probably start with the origination process to outline the kind of legal framework we have in Russia. When I was looking at Rory's slides I saw quite a nice slide *Developing a Sound Legal Framework*. It said that a sound framework includes sections on what a mortgage means, and Rory describes what the mortgage law should look like. I discovered that it is speaking

about Russian mortgage law, because that is exactly what Russian mortgage law says, and it was adopted in 1998. I would not say it is a perfect law, but it is a good law, and it is exactly what Rory is looking for: what is the mortgage, how is the mortgage enforced, how does the system of registration work, how does insurance work, how does enforcement work and how does the assignment of mortgages work for secondary market purposes?

What was very important in 1998 was that the mortgage law provided for the possibility of termination of occupation rights by those who live in the apartment. There was a huge debate - and I guess in Ukraine and Romania - about how to address this particular point. Finally, in Russia it was decided that if you enforce against a mortgaged property, then the occupation rights of those who live in the apartment terminate if the mortgage was taken for the purpose of purchasing the apartment. It is a very strange thing in Russia. For example, if you take a mortgage loan, not to purchase the apartment but for general purposes, then this provision does not work. Therefore, allegedly those who live in the apartment do not lose this right. Therefore, if you go to the Russian bank to take a mortgage for general purposes the interest rate will be 2 per cent higher than in a mortgage where you take it for the purpose of purchasing the apartment. On the other hand, whether or not we make this decision in Russia, if in Russia we were to have a disaster like the sub-prime one in the States, it is a question of whether the state would change the rules of the game because let us say in a town the average temperature is minus 40 or minus 50 in winter, I cannot imagine a judge taking a decision to throw a family and kids on to the street.

That is a good question for the rating agencies, for rating Russian securitisations: what would the stress scenario be? What would the Russian state need to do to make all these declarations viable? The way to do it is to create a sizeable social fund where people who are unable to pay their mortgages may be relegated.

A couple of years ago there were something like 21 law cases in Moscow involving throwing people out of their apartment for not paying utility bills - and the question was: Why 21? The reason is that there were only 21 places available in the social fund. That was a quite interesting question, particularly for the rating agencies.

Another thing that was introduced by the 1998 law, which is quite important, is a special mortgage security, which is called *zakladnaya*. This made securitisations. Basically, it made the secondary market more flexible because you just transfer the rights to the mortgage, not by way of a cumbersome registration procedure, which takes one to two months, but basically by putting the endorsement on the piece of paper. That is what is happening. The first Russian securitisation was VTB in 2006, a cross-border mortgage securitisation, and at the time VTB did not have the *zakladnaya*; they had only registered mortgages. They were lucky because they were VTB, a state-owned bank, and there was a sufficient level of creditworthiness so that investors could finance VTB on an unsecured basis and wait for two or three months while VTB re-registered thousands of mortgages with the registration authorities.

All the other securitisations happened with mortgage certificates because the other banks that were involved with securitisation simply could not afford it, or the investors would not give them money and wait while they registered their mortgages.

If you look at VTB, I would say the majority of the portfolio is in mortgage certificates.

One of the amendments that the regulators want to introduce is to go further and introduce the custodial recording of the mortgages so that effectively you would be able to trade mortgage certificates without any physical involvement, but basically giving an instruction to the custodian to transfer the mortgages to the deposit account of the purchaser. That will facilitate the securitisation transactions.

What is currently crucial for Russia in terms of amendment of the securitisation framework, the re-financing framework, is that many Russian banks like liquidity because of the credit crunch and the banking crisis, and many people are looking to the Central Bank as the lender of last resort. The Central Bank is trading under the conditions of the repo ... trade with various banks, but they need to include in the so-called loan portfolios the securities with which the Central Bank would be happy to trade. In a nutshell, the repo transaction is where the Russian bank would sell to the Central Bank securities at a hundred with an obligation to repay at 105, thus receiving medium to short-term refinancing.

There is a big lobby to include in this Lombard list of mortgage-backed securities, but the Central Bank does not know how to assess those securities, particularly taking into account what has happened in the States. Therefore, they propose to deal with the situation by having mortgage-backed securities secured not only by the pool of mortgages but also by a guarantee from an institution with a minimum rating from one of the three rating agencies. It covered one type of instrument. Apparently, a couple of weeks ago the Central Bank took this decision, but nobody has seen it published so far. We will see how it will open up the financing of small or medium sized regional banks that provide mortgages.

Another quite important matter is amending the current mortgage-backed securities law, because in Russia that law governs domestic securitisation. Unfortunately, at the moment it is much easier to do cross-border securitisation, and that is what has been done by VTB, City Mortgage Bank, Delta Credit and some other banks, so it is easier to establish the SPV in Luxembourg, Netherlands or Ireland and do the securitisation on a cross-border basis, rather than do a domestic securitisation, because it takes much more time. Also, there are some difficult questions from the rating agencies in terms of bankruptcy and removal of the Russian SPV.

There are various working groups in Russia, working on amendments to the Russian domestic securitisations. Actually, there are three Russian domestic securitisations under Russian securitisation law. The first one was that of Gazprombank, and then a domestic securitisation by the entity called AHML - Agency for Housing, Lending, Mortgages. It is a Russian state institution that finances the regional banks by buying mortgages from the regional banks. There are two securitisations of AHML. When we started working with AHML back in 2004 we realised that the law simply did not allow for domestic securitisation, so it took us a year and a half with AHML to change the law. It was in 2007 when the first transaction took place.

Unfortunately, the current market is not that great and we do not see many public ... deals; actually we do not see any out of Russia, and I guess this is true for many other markets.

Currently we see in housing privately-placed transactions where various banks like VTB and other Russian banks are also doing that, but changing legislation in Russia is proving to be quite a difficult task. It is very difficult to find where the centre of influence is and how this particular group could change the legislation in the right way, because there are fundamental issues for Russian domestic securitisation law in such as whether or not the Russian SPV is bankrupt. Other portions used to be done better, but taking into account one of the last features of Mr Putin's term, he was basically looking for Russia to become one of the biggest financial centres, and according to him there will be big centres for developing Russian legislation governing the financial markets up to the highest Western standards, so hopefully this will have more ability to change the laws in a better fashion. It will have one of the most advanced regulations, which should allow Russia to become one of the world's financial centres.

THE MODERATOR: Thank you. That was a fascinating outlook on what other markets will be aiming at developing.

We have five or seven minutes for questions, so I will re-open the floor.

A PARTICIPANT (EBRD): I would like to return to the issue of the legislative framework on mortgage market development. We have had some very interesting and sometimes conflicting statements. Angela tells us that one of the triggers for market development was the new legislation in 2000. Andrei tells us that in Romania the mortgage lending law was not particularly instrumental in developing the market and that the market would have gone anyway. Perhaps Rory can be the judge of these views! In your experience, working in many jurisdictions, how instrumental is the legislative framework in developing the market?

MR SPAIN: It is a question of the level of confidence in the particular country at a point in time. As you have said, Andrei, possibly it is not necessary to have a mortgage law. If the banking system is such, and the lenders and legislators are happy to work under banking law, that is good enough. If, at a point in time in the development of a country it feels it needs a mortgage law in order to kick-start a mortgage lending programme, then it is necessary because it is all about confidence.

If the legislators, the bankers and the people in the country feel they need a law in order to get them going, then it is necessary. That is just trying to answer that it is based on need rather than legal need.

MR BURZ-PINZARI: I would say that there are segments of the mortgage market that cannot exist without special law. We can talk about assignment of mortgage portfolios and securitisation but mortgage bonds definitely need a special law. In Romania, you could not have mortgage bonds without a mortgage bonds law. The mortgage lending law was very useful for mortgage loans provided by non-banking financial institutions, so it is important to make that remark. It was also useful that it introduced the concept of a mortgage on a future property. Unfortunately, when it was introduced in 1999 it was not done properly and therefore it was not used until 2006 when the mortgage lending law was amended.

Perhaps I am just looking at it from a technical perspective, but my view is that mortgage lending would also have developed without a special law because from a technical perspective I do not believe it was a “must”. From a practical perspective it is possible that the existence of special mortgage lending will help the market for the psychological reason mentioned by Rory; that people like to see that something is regulated in law because then they are more comfortable instead of relying on general principles, or going to the civil code, which bankers would not usually do - they would go to the banking law. From the psychological perspective, a mortgage lending law helped. From the technical perspective it could have been done anyway.

MS PRIGOZHINA: In Ukraine before we had mortgage laws we had a legacy of certain practices of some banks and non-banks that had been doing mortgage lending by mobilising investment resources from households. In Ukraine the only way to do it in the right way and to attract attention and make the effort to develop a mortgage market in the right way was the passage of mortgage legislation and massive public communication of what a mortgage is, how it should be done, and why people should not be scared of any possible bankruptcies or malfunction of financial intermediaries; so the mortgage law was a trigger.

We are still combating the problem of co-existing legislation because the second non-conventional scheme - as soon as the mortgage law was passed they realised they were losing the market, because all the people - given the existing legal practices and the psychological comfort that if there is a law, there is a court, there is a judge and there is a regulator - so the second group has rushed to pass its own legislation, which unfortunately at the moment is carved in stone, and we have to fight with this or somehow contemplate it. I hope that we will amend the second set of legislation really soon, and we are waiting at the moment. I see here some of the best mortgage lenders in this group, who can confirm how mortgage law has helped Ukraine.

THE MODERATOR: Certainly I was fascinated to hear the various testimonies of legal development, which confirm that it is a delicate balance to achieve between developing new laws, consulting and revising existing laws. It seems to me that the target is always moving with the market. Russia is also trying to fine-tune, taking into account what more advanced markets are doing. For the region it is fair to say that the cycle has not gone full circle. There has not yet been a major downturn in the property market, which of course will test the laws and institutions to the full; so we still have to see how these developments fare in this respect.

I thank all the panellists. Please give them a round of applause. **(Applause)**

The General Counsel, Emmanuel Maurice will now address the audience of the launch of *Law in Transition*.

MR MAURICE: Thank you very much. I would like first to thank the participants of this panel; thank you for a very interesting seminar. I thank all of you for attending this conference. I hope that the ideas that have been discussed here will help shape the law reform agenda in your countries and help the policy-makers to make better laws in your respective countries, ensuring a better enforcement of those laws.

I would like to take two minutes of your time to introduce what has been available outside on the tables, which is the latest issue of *Law in Transition*, which is published in the context of this Annual Meeting. It is the legal journal of the Bank, which we publish twice a year. This one is focused on two themes: the first is

securities markets. You all know that the securities markets are key ingredients of market economies. Securities markets foster investment and the growth of the private sector through investments and savings, and therefore they are quite important in the context of the transition process.

You will see a number of articles on the securities markets. The countries of operations of the Bank are at various stages in transition in the field of securities markets. Obviously, they all need to pay more attention to those laws, whether by better enforcement and implementation of the good laws they already have on the books or by going back to the drawing board and adopting laws that conform to the international standards.

The second part of this issue is dedicated to Ukraine. Obviously, you understand why we had to have a focused section on this country, which is hosting the Annual Meeting of the EBRD this year. We all witnessed the very vibrant democratic society of Ukraine and the very dynamic economy that this country enjoys, and we wanted to take this opportunity to publish a few articles about their laws. You will see that there is a very interesting article on the assessment of the commercial laws of Ukraine, but you will also see a number of other interesting articles on corporate governance, on construction financing, and on the new and long-awaited joint stock company law in this country. I am sure you will enjoy reading these articles and this issue, as much as we have enjoyed preparing it for you.

I would now like to celebrate the release of this issue with drinks outside the room. I thank you very much for your attention. **(Applause)**