

# The expert opinion and position of the Mortgage Credit Foundation on EBRD Report:

*"Mortgages in transition economies.  
The legal framework for mortgages  
and mortgage securities (January 2008)"*

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**Warsaw, 1 August 2008**

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on:

**“Mortgages in transition economies. The legal framework for mortgages and mortgage securities (January 2008)”**

**Report of the European Bank for Reconstruction and Development**

(hereinafter "the Report");

report available at <http://www.ebrd.com/pubs/legal/mit.htm>

*English translation - based on the Polish position paper to the EBRD study, prepared by the Polish Mortgage Credit Foundation, dated 1<sup>st</sup> of August, 2008.*

**Nature, purpose, addressees of the Foundation's position**

This expert opinion applies to the report as a research work and its results in the form of composite tables. It contains:

- assessment of methodological consistency,
- assessment of whether the comparison techniques are adequate to the subject studied;
- assessment of whether the quality rating of particular legal systems is consistent with the database of collected substantial information and the selection of its sources;
- relationship between the comparative assessments and the assumed priorities, question matrix and the recommended reforms.

**Warsaw, 1 August 2008**

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## I. General assessment and contents of the EBRD Report in comparison with the intentions expressed by the authors

### 1) Valuable research study, innovative approach

The EBRD Report is a comprehensively conducted study on selected elements of the law and practice of mortgage lending in 17 Central and Eastern Europe (CEE) and Central Asia countries, which should be highly appreciated. The study is a valuable cognitive and law-comparison source presenting an original subjective approach both to the selection of areas studied and to the assessment criteria for individual national legal systems; consequently it represents a novel (in many respects) contribution to the development of studies of international aspects of mortgage financing and its legal infrastructure.

### 2) The EBRD Report does not assume comprehensiveness and adequacy to market specificity

However, it should be noted from the start that, as the authors themselves emphasise, the report cannot be considered a complete and exhaustive presentation. In particular, it does not fit the market specificity.

*"The information covered by the survey is not comprehensive enough to provide a full assessment (especially for measuring fit-to-context). However, the results do provide a fair indication of what has been achieved in each country and useful pointers to what needs to be improved."*

*EBRD, p. 32*

Indeed, when the contents of the report are analysed, this feature should be considered its weakness, particularly due to the limited database of research information. Therefore, it is all the more surprising that the above fact does not stop the report's authors from making far reaching conclusions on the quality and rating of particular national systems and their mutual comparisons (see for example the table on p. 58, 59).

The point of reference in the Report is the universal, model standards laid out in its core principles, whose fulfilment is to assure the successful development of mortgage markets (**cf. Core Principles, p. 11 of the EBRD Report, and item V below [assessment of recommendations]**). The assumptions made here, the risk grading, **the exemplary models adopted by the EBRD are of key importance for the resultant assessment of the particular national systems**, the arrangement of questionnaires etc. The conclusions formulated as a result are presented as composite tables (scoreboards – cf. p. 58 of the EBRD Report).

However, there are significant **reservations** as to whether the input standards, laws and practices of mortgage financing can and should actually constitute a universal model to be implemented in CEE countries **without any damage to and increasing the risk** of mortgage financing. A number of controversies arise from the suggested method of implementing the recommendations.

### 3) Problem with defining the reference system

The point of reference which the authors quoted multiple times has not been precisely defined anywhere in the report. This methodological shortcoming means that many of the recommended goals are of a positive but idealistic and utopian nature, while not achieving those goals earns negative scores in scoreboards.

In the context of the goal to which CEE countries should aspire, the authors refer e.g. to 'contemporary global mortgage markets' in looking for the 'efficiency of the mortgage law' which the report authors believe to be lacking in CEE countries<sup>1</sup>.

*"The purpose of his work is to look at mortgage law **as it is currently used** in transition countries **against the background of contemporary markets** for mortgage finance as they are developing globally".*

EBRD, p. 5

Sometimes, the authors quote advanced markets as a model – however, this comparison also seems rather abstract, as the part of the report dealing more specifically with the achievements of those markets presents the **legal systems** for the operation of mortgage financing **in Germany or France as negative examples**. On the other hand, the authors perceive that in many reforms, CEE countries have advanced beyond old EU members.

### 4) EBRD recommendations based on the USA experience with no analysis of the effect in the conditions of the (continental) European legal system

It can be recognized from the report, that the solutions deriving from the USA practice, seem to be used as a reference point for suggested solutions in mortgage financing legal infrastructure (for example: out of court foreclosure procedures, automatic out of court mortgage registration). Unfortunately, those recommended assumptions of the Anglo-Saxon system and practice are not accompanied by an analysis of differences from the European law, which results in **many misunderstandings or even a risk of using the EBRD recommendations with opposite effects to those intended**.

This is evidenced in the preference for and the adoption of the **following priorities** as the core principles of the system of values and scoreboards, alien to some European legal systems:

- The priority of establishing the ownership of the property, with only secondary treatment of the exclusively independent legal entity of the collateral which the mortgage represents in many European orders;
- As a result, in the assessment system of the report, any procedures aiming at the substantive law institution and regularity of the mortgage as such (e.g. upon mortgage registration), are considered superfluous and earn negative scores as a 'complication' of the system;
- As recommended by the authors, the role of land registers should come down to just recording information – good faith, liability for entries and, in particular, any role of judges is treated here as an obstruction or something actually increasing the risk of financing;

<sup>1</sup> The first example of global mortgage markets that springs to mind, making headlines recently, is the markets of mortgage asset securitisation, but they do not seem to be the right goal to strive for. In general, when talking of the reference system, the report neither includes nor cites the experience of the **sub-prime crisis**.

- The priority for and the recommendation that enforcement from the property financed by the mortgage loan should be conducted in an out-of-court procedure, which is the standard of enforcing rights under the mortgage furthest from the European solutions, and the resultant recommendation of a systemic assurance of the passive position of the mortgage borrower (only the legal comfort of the party enforcing from the property is used as the reference point for assessing national systems);
- The assessment scale of the EBRD Report provides for a **very unfavourable** treatment of the **role of the legal doctrine**, custom and history; however, in many European systems, these are considered the mainstays of the durability and stable continuation of the legal framework of mortgage financing, in view of its very long-term nature. Report authors treat these characteristics as the reason why the mortgage is, for example, inflexible and difficult to transfer, and they contrast them with the better philosophy of the Anglo-Saxon law under which particular solutions are created and tailored to specific transactions (e.g. EBRD suggests easier transfer for securitisation instead of a comprehensive reform of accessory);
- In the report, the time that it takes to enter a mortgage and to enforce from the property is the universal objective and primary measure for giving positive ratings of the reliability of particular national legal systems in the analysed countries, even **at the cost of the quality and incontrovertibility of the mortgage**. Criterion of the incontrovertibility (stability) of the mortgage is altogether missing from the EBRD core principles (EBRD study, p. 11).

## 5) Controversies around treating in the report the time as the absolute overriding criterion for assessing legal system quality

### a. MORTGAGE REGISTRATION TIME

The greatest controversies are about the emphasis on the criterion of the waiting time for mortgage registration and the time necessary to enforce from a property as the main measure of the image and reliability of particular systems.

While there is no known system or reform efforts that would not set as one of their main priorities the achievement of the shortest waiting times for the institution of and enforcement from the mortgage, the legislature may find the method of achieving this goal recommended in the report controversial.

What is recommended as part of the reform proposed by the EBRD, i.e. **to reduce the system of mortgage establishment to the mechanical, disclosed register, without any public warranty or legal presumptions**, is throwing the baby out with the bathwater (to shorten the registration time).

In the case of the Polish system, **if the recommendation were fulfilled, this would destroy the reliability of trade** in the real estate market and the certainty of the existence of collaterals, as the positive warranty of land registers and the confidence in the contents of land registers guaranteed by the judiciary are essential for this reliability. In Poland, without the positive warranty of land registers, the real estate purchaser would not be legally protected as to the effective purchase of the real estate.

### b. ENFORCEMENT TIME

With regard to efficient recovery, it is obviously possible to achieve lightning speeds of enforcing from properties, but unfortunately only **by eliminating** procedures and the **legal protection for those evicted**, which is of great importance in the European practice.

With regard to the 'short' enforcement, the report sets a rather utopian goal as the model, namely to get close to the US situation (out of court procedure); according to the report (Chart 6, p. 27), this was achieved only in Kazakhstan, the Slovak Republic and Ukraine.

Further in the report it turns out that this subject was researched in isolation from the actual conditions and the crucial practical problem in this field, namely the eviction and the legal protection for those evicted, who, unlike in the US, generally enjoy such rights in Europe (**cf. the inconsistent table**, for instance for Ukraine the shortest enforcement time – Chart on p. 27 EBRD, and at the same time rights of those evicted particularly unfavourable for the mortgage creditor – p. 37 EBRD, bottom).

c. **Summary: the time as the most important measure of the quality of mortgage systems is used in the EBRD Report incorrectly:**

- The methodological doubts refer to **imprecise question in the questionnaire for international comparisons**: is it about the duration of formalities or the time including the enforcement; similarly, the starting point of enforcement and the identification of whether the subject compared is residential or commercial enforcement require uniformity and precision; with regard to the entry of the mortgage – is it about the time of its registry in the technical sense, or the time including also the compilation of documents and the drawing up of the application;
- From the point of view of the risk in mortgage financing it does not seem right to treat the short waiting time as more important than stability and certainty of mortgage;
- The short waiting time for mortgage registration or enforcement is the goal of every reform, but it seems that countries reforming their systems are right in striving to improve those indicators without giving up the role of courts and the public warranty as well as the liability for the contents of mortgage entries.



## 6) Composite tables and scoreboards as the weakest and unreliable part of the EBRD Report<sup>2</sup>

The problem of adopting ideal assumptions for the operation of the mortgage in European markets – based on US conditions, coupled with the inconsistent methodology and shallow information database on the systems of particular markets – means that the composite tables and scoreboards should be considered the weakest and least credible part of the report.

To refer again to the above examples of how Ukraine was presented: if the Chart on page 27 EBRD "*Efficiency of mortgage enforcement*" (which comprises the cost, the percentage of recovery and the duration of proceedings) included the reality of evictions, Ukraine would probably not achieve a 100% positive score. On the other hand, the Chart on page 38 "*Legal efficiency – certainty*" indicating that Ukraine is the only country in which the mortgage is completely unreliable takes into account the problem with evictions, which is a factor for Ukraine, and which has not been compared for the other countries in the same Chart. However, it is also obvious that problems with the eviction also impact the certainty of the existence of the collateral and even more the certainty of recovering it.

## 7) Reproach of inadequate methodology

The above shows the **problems which recur in the part of the report which compares the assessments of national systems, making those scoreboards unreliable, namely:**

- A random use of the positive or negative information concerning a given country instead of a large-scale analysis of the subject in all the researched systems using the same precise criteria;
- Quantitative comparisons mainly using the measure of time of waiting for registration or enforcement for completely different systems, without precisely defining the subject compared and the reference point, e.g. commercial versus residential properties, the registration only intended to disclose information that the property is charged, or the time counted from the moment when full substantive law effects of instituting the mortgage arise;
- In composite tables, which are based on the subjective assessment by a respondent (e.g. Chart on page 35 – "*Legal efficiency – simplicity*") – there are **major disproportions in the number and categories of respondents** – in some countries there were just 3 or 5, in others 15 of them (c.f. pages 2 and 3), in some countries those respondents were exclusively market practitioners, and what is more, specialising in complex transactions in the commercial market, while in others the respondents were mainly representatives of regulators or the government: so there is no common **reference point for the type of transactions being compared or the categories of respondents** presenting their opinions, and this clearly affects the comparability of results;
- The scoreboards mix up comparisons: for some countries what is compared is information taken directly from regulations with information about the actual practice, but for other countries the comparison is with the practice in specific cases (with regard to the same issue being compared), in some

<sup>2</sup> By tables and **scoreboards** we mean tables no. 5-11; table 5 p. 40 and the main comparative table in Annex 2 p. 58 "composite table".

cases the item compared includes the effects of reforms, e.g. the computerization of land registers, while in other countries the reform process and its effects have been completely ignored;

- With regard to the whole report, and in particular the composite tables, the authors declared focusing on the mortgage lending practice – "law in practice, not in books". However, in many cases, as indicated by the analysis of information about the Polish system, standards commonplace in the banking practice, such as the use of the so-called bank mortgage restricting the involvement of the notary, or of the bank enforcement title (which replaces the court investigation procedure ) and the existence of banking standards for selecting the type of mortgage for the type of debt have been completely ignored and replaced with the reference to and the assessment of textbooks solutions, which are only rarely applied in the general commerce.

## II. Significance of the EBRD Report and its practical importance for market behaviours and reform direction

### 1) The significance of the report stems mainly from its being the **first** clear attempt to rate the reliability of mortgage law systems of the 17 analysed CEE countries

The attempt to rate the efficiency of the law in particular countries is the first publication of this type by an institution of importance on the market, in particular supported by the international credibility of EBRD as a bank with a high standard of credit risk assessment and extensive experience in analysing markets within the international range of its activity. Above all, the important contribution of EBRD to the analysis and reform of law of movable property pledges in many reforming countries should be appreciated.

### Negative assessment of the EBRD credibility of mortgage systems of CEE countries

However, it should be noted that the EBRD Report finds the examined systems to be of low quality, particularly in such important dimensions **as the efficiency of recording mortgages and of enforcing from mortgage collateral**. Ten of the analysed countries were found to have low efficiency in these two fields (the Czech Republic, Estonia, Poland, Russia, Slovenia, Hungary, Kazakhstan, Latvia, Serbia, the Slovak Republic) and in the case of Ukraine, for instance, although the efficiency of enforcement has received a high score, the certainty of collateral scored the rock bottom of the scale.

The report also gives a low assessment of the general legal conditions for mortgage business development in the region, negligence in reforms, no practice in using the ownership of real estate as the source of capital and collateral (cf. remarks and comments in item III of this document).

### 3) There are no comparative and evaluating publications which would be so comprehensive and adequate to the EBRD Report

The report authors have made a bold decision to assess the quality of individual mortgage law systems, from which other institutions significant for this field, like universities or analytical departments of international groups financing property markets, rating agencies and the like have so far shirked.

Confirming or disputing this assessment is difficult in the light of existing reports, as, due to the novel value of the above report, there are almost no peers that it could be compared to.

However, one has to cite the report of the European Mortgage Federation, as this institution, grouping over 75% of the European mortgage market, is renowned for its expert analyses of legislation. **The conclusion of the EMF research of 2007 called the "Study on the Efficiency of the Mortgage Collateral in the European Union"**, forming the message of the European Mortgage Federation to

the European Commission in its work on the White Paper on Mortgage Credit, states: **"all the researched markets are characterised by high efficiency."** Along with the majority of EU Member States, this study covers also the countries included in the EBRD Report - Hungary and Poland. So the fact that the legal infrastructure for the efficiency of these countries has the standard of high security typical for the European Union, when compared with its low assessment by the EBRD, casts a shadow on the assessment of EU systems in general and seems to undermine either the EBRD Report or the analysis by the European Mortgage Federation.

An eagerly awaited document is the **comparative study by the VDP (Association of German Pfandbrief Banks) – Otmar M. Stoecker (red.) - "Flexibilität der Grundpfandrechte in Europa"** which has been conducted since 2005 and which is based on an in-depth, precisely maintained analytical database for many countries, taking into account the experience and the defined critical points for member institutes' assessments of systems.<sup>3</sup>

#### **4) Simplicity and clarity of the EBRD system ratings as the greatest advantage and risk encouraging for use of the report conclusions**

The report is so significant mainly due to the novel formula of comparative legal analysis: the assessment of the legal efficiency, capacity and certainty of the legal infrastructure for mortgage loans according to the characteristics of infrastructural weaknesses of individual markets.

This is because so far the attempts to assess the reliability of mortgage collateral in international business, either to get covered bonds (mortgage bonds, securitisation titles and other mortgage-backed securities) rated, or to obtain permits of bank supervision authorities to run a cross-border mortgage business – due to the generally accepted sophistication of the subject and its specific nature on each domestic market – **have been the subject of legal analyses and studies, both complicated and expensive, conducted by reputable law firms.**

As the sophistication and complexity of regulations is widely known to be a problem in analytical work on the legal framework of mortgage loans, in this context **the simplicity of the legal system quality assessment in the form of the number of pluses or minuses awarded, printed on just two A4 pages for 17 countries, seems to be a ground-breaking solution** (cf. Annex 2 p. 58 of the EBRD Report). Anyway, this approach is in harmony with the express assumptions by the report authors that the report is intended as a reference material.

#### **Business/financial impact of the report, international capital allocations**

Consequently, the EBRD Report can save time and expense for many institutions involved in placing capital, recommending such investments and rating assets, which do this from the business perspective but at the same time need to have a

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<sup>3</sup> For further information, see vdp webpage: [www.pfandbrief.de](http://www.pfandbrief.de). The results of the first stage of the study have been published in: Otmar M. Stoecker (red), "Flexibilität der Grundpfandrechte in Europa" Band I Ergebnisse der Workshops vom Juni 2005/Dezember 2005/Juni 2006 in Berlin, published by vdp; and Otmar M. Stoecker (red) "Flexibilität der Grundpfandrechte in Europa" Band II Ergebnisse des Workshops vom September 2007 in Berlin, published by vdp. Cf. also ref. 6.

legal point of reference and an assessment of the systemic certainty legitimizing the decisions they take or suggest.

Due to the unquestioned reputation of EBRD and the resultant implied substantive credibility of the report, this report and in particular the simplified composite tables rating the markets can be expected to play a major **role in international capital allocation**, to **impact the price of local money refinancing** mortgage loans, and also to result in a stronger or weaker tendency to invest in a given country or region.

Due to the spectrum of the analysed issues, the deliverables, and in particular the scoreboard, can be of particular significance for the **quality assessment of mortgage-backed securities**, i.e. MBS bonds and covered bonds, as well as for the ratings of banks whose assets include significant proportions of mortgage loans. This is because the scope of partial questions coincides with the model of rating agencies' and analysts' reviews of the certainty of collateral for the above securities.

## 6) Setting the direction and standard of EC work to integrate mortgage markets

It is also presumed that the EBRD Report will play a major role in the current work of the **European Commission** on the idea for and the practical integration of European mortgage markets. It should be noted that one effect of this process is the White Paper on Mortgage Credit published in December 2007, and one of the priority tasks for 2008 is for the Commission to conduct a periodic scoreboard analysis.

**It seems to be an important coincidence** that the EBRD Report was published, as it ties into not only the idea but also the method by which the European Commission will execute its research. So the EBRD Report can be supposed to become an important basis not just for the results, but also for the methodology which the European Commission will soon select to execute its work. In particular, the recommendations of the EBRD Report related to improving the efficiency of mortgage markets seem to converge with the intentions of the Commission, which is therefore likely to use the conclusions of the EBRD Report in its further activities.

### Concerns

The assumed major significance of the report gives rise to some concerns, not so much because of publishing the simplified rating of legal systems, but because of the presumption that this table is backed not just by the EBRD reputation, but also in-depth research techniques (diligent analyses, a cohesive and adequate methodology). This would be the effect of acceptance of the report as reference material by market analysts, investors or the EC.

The preliminary analysis of the report from the point of view of just one country and the information included about that country gives rise to concerns whether the above assumptions have really been fulfilled.

We would like to voice our concerns here that, in the case of Poland, a report of such major significance was not subjected to assessments by a representative (also in terms of the market share) institution (in the case of other countries, like Romania or Ukraine, the Report authors contacted **22** respondents as compared to **just 3 from Poland**, so our market has been treated rather cursorily). This is why

the Polish party would all the more like to express its disappointment that the report has not been given the chance to be evaluated by both the Polish Mortgage Credit Foundation and leading ministries, unlike the previous ones, even if those evaluations had been critical.

Consequently, the corrections below, as presented after the publication of the report, will no longer change its quality and result, which we regret, as we believe the report to have major opinion-forming significance for investors and analysts. We hope that EBRD, as an internationally trusted institution, will make every effort so that in addition to the report already sent, its **addressees are given the opportunity to review the corrections of the facts and the picture of the Polish market painted by the report.**

It would also be certainly informative to collect the assessments of the report that may be expressed by other countries. This is because the report certainly, as intended, inspires a creative discussion on the efficiency of mortgage systems.

To summarise: we foresee a negative impact of the report on the rating of mortgage bonds, securitisation products, ratings of banks with major proportions of mortgage portfolios, undermining of the credibility of mortgages and as a result the risk of increased loan cost – **should rating agencies or investors base their decisions in the CEE region on conclusions in the EBRD Report.**

### **III. General assessment of the risk and legal infrastructure in 17 Central and Eastern European markets studied, ensuing from the report – remarks.**

#### **1) In general, the EBRD Report creates a negative image of credibility and efficiency of the mortgage markets in the 17 countries studied**

Admittedly, as regards some of the aspects that were studied, rather randomly referred technical solutions of the systems used in some of the countries that were studied are being approved, i.e. they are getting positive scores in the comparison tables shown in the report – however, **the principal assessment presented in general terms in the report does not look positive for the Central and Eastern European region where it is merged into a single region from the point of view of the investor's risk.**

The descriptive assessment of the national systems should rather be separated from the detailed part – “*national survey*”, where the authors adopted a rule of expressing general remarks having a relevance to all systems that were analysed, unless the given nation positively or negatively deviates from the opinion – where this is clearly emphasised.

The report points out that all countries - regardless of whether they have already been members of the European Union for the past 4 years (the Czech Republic, the Slovak Republic, Hungary, Poland) or they acceded the European Union in 2007 or are not members of the EU - require an in-depth mortgage reform, and sometimes also a change of the reform direction. In contrast to the USA and the founding members until 2004, all 17 countries are homogeneously treated as “transition economies”, which ensues from the title itself as well as each assessment.

Just to recall, the following countries are a subject of a joint and comparative assessment: Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, the Kyrgyz Republic, Lithuania, Latvia, Poland, Romania, Russia, Serbia, the Slovak Republic, Slovenia and Ukraine.

#### **2) General assessment of EBRD – no reforms of the mortgage law or improper path**

- according to EBRD, the countries that were studied do not show determination in reforming the mortgage law;
- although there is a legislation governing securities based on mortgage, the legal provisions specifically covering mortgage as security have been largely overlooked;
- even if there were some reforms, EBRD believes that they “have not always been developed in the most rational and legally efficient way”.

*“Mortgage law reform is not necessarily high on the agenda for many transition countries.”*

*“the legal provisions specifically covering mortgage as security have been largely overlooked”*

*“There has been a good deal of reform activity concerning land law, title to real property and registration, and now laws are being introduced to encourage the use of CBs and MBS (referred*

*to together as "mortgage securities"), but the legal provisions specifically covering mortgage as security have been largely overlooked. And yet mortgage rules have not always developed in the most rational and legally efficient way."*

EBRD, p.4

### COMMENT of the Foundation to the EBRD conclusions

It seems that such uncompromising assessment of the level of reforms could have been affected by **the lack of knowledge of the report authors about a number of reforms taking place**, especially in the countries where the political system changed as early as the '80s; as a confirmation please compare the analysis of the Polish example and information about intensive reforms of the mortgage law already accomplished, which is not consistently referred to in the report (at least analogically to comparable reforms in other countries) and also included in the detailed part of the report – in comparisons.

As regards the allegedly wrong direction of the reforms – the point is to define which direction of the reform is the correct one (cf. remarks in item V of this document). The report authors frequently express a view that is different to the national reformers, good examples of which are the notion of the role of the registers, the proposal to break off with the doctrine and tradition of the mortgage law towards an unspecified modernity, founding the reforms on pragmatic and simple regulations replacing the efforts to carry out comprehensive reforms.

### 3) General assessment in the EBRD Report: the markets in question are starting to build the mortgage market, are only at the start of the mortgage reform path and do not have a vision of reforms

The report clearly assumes that the markets studied lack their own experiences and ability to make assessments and specifications of the necessary reform measures. According to EBRD, the development stage of these countries indicates a need to seek model solutions in developed countries – as to the ways of increasing mortgage lending.

Since the report authors in principle **do not recommend using the model solutions of the developed European countries such as Germany or France**, this document is supposed to constitute a desired guideline for necessary and justified reforms.<sup>4</sup>

*"Naturally, transition countries are keen to understand the factors that determine market growth for mortgage credit in advanced economies."*

*"It is hoped that the Mortgage Regional Survey that is published as part of this work will provide a useful basis for assessment and comparison and will become a reference point that provokes discussion and improvements to mortgage laws, especially among those who make or influence legal reform policy in the region, enabling them to improve their mortgage laws in order to achieve "legal efficiency"."*

EBRD, p. 7

### COMMENT to the EBRD conclusions:

Citation of the above approach of the EBRD Report authors to the issue of development achievements of the mortgage markets, they consider mediocre, **is the more significant that erroneous assumptions as to the facts** regarding

<sup>4</sup> Cf. p. 7 of the EBRD Report "*Mortgage regional study*" pursuant to the objective of the report, is supposed to serve as the reference point for improving the mortgage law and, in consequence, achieving a "*legal efficiency*".

**"Naturally, transition countries are keen to** understand the factors that determine market growth for mortgage credit in advanced economies, and consequently what may be needed to encourage and maintain growth in their own markets" EBRD.



the dynamics of the growth of mortgage markets in the 17 countries studied provide an **erroneous belief** (visible in a number of detailed summaries presented in the report) **that the countries' own experiences** and specifics of each market principally **do not deserve to be included in their own vision in the reform process** – instead, the report gives primacy to universal, or rather model (as considered in the report) American solutions (see item I.4. of this document).

The report sometimes simply formulates assumptions for the desired models of procedures, deviations from which are given negative scores in the comparison tables – regardless of the fact that maybe the risk concerned is covered by the law in some other way that fits the local solutions (see item I.7 of this document *Reproach of inadequate methodology*)<sup>5</sup>. Nonetheless, the authors admit that the task referred to in the report as “fit-to-context” was not found to be relevant. It is, in a way, a consequence of an initial assumption **that the markets studied are only at the start of the mortgage reform path, or are just discovering what real property ownership is**, where EBRD states that: “in Central and Eastern Europe access to private home ownership is a relatively recent phenomenon” (see comment to item I of this document).

*“In central and eastern Europe and central Asia, access to private home ownership is a relatively recent phenomenon, principally as a result of the privatization policy of governments moving from a communist to a capitalism system”*

EBRD, p. 4

Meanwhile, if we are to consider the knowledge of high advancement of the markets in question, **an overwhelming majority of the countries studied no longer have an open way of choosing the reform path**, and the “about-turns” in the adopted solutions may lead to mortgage financing-related risks which the authors of the report do not foresee due to ignorance of reform progress or due to failure to respect the reforms.

To be more precise, it is worth citing the statistics indicating that for majority of the countries studied by EBRD the issue of how to achieve market dynamics is not the greatest problem at present. Experience gained – such as in the case of Poland, for instance – during millions of transactions and numerous legal variations of the mortgage financing structure – where, contrary to what the authors believe, mortgage became a credible and feasible security, and the quality of the mortgage portfolio is good in the opinion of the banking supervision authority, create an expectation or even a requirement that when preparing renown reports such as the one prepared by EBRD, data used in the analyses respect local conditions and knowledge about them.

As regards the recommended changes or reforms – it is not expected that an “ABC” level be achieved – see p. 11 of the EBRD Report – but if a report having a significant influence on the investment climate puts forward any conclusions or recommendations, it is expected that they be on a high and precise level of advancement – adequately to the market and its complex structures and legal solutions. Meanwhile (at least such is the case of Poland), the information about the market and its legal infrastructure used in the report as well as the

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<sup>5</sup> An example of another and more appropriate approach is the methodology adopted in the study conducted since 2005 by the Association of German Pfandbrief Banks (vdp): Runder Tisch “Flexibilität der Grundpfandrechte in Europa”/ “Flexibility of Land Mortgage Bonds in the Central Europe”. Representatives of more than ten Central Europe countries (including Bosnia and Herzegovina, Germany, Estonia, Croatia, Austria, Poland, Slovenia, Hungary) – both representatives of scientific groups and banking practitioners – participate in the study, conducted partially in the form of workshops. The purpose of the workshops is to compare the legal systems of the above countries in the aspect of real estate collateral, level of their accessory and the possibilities which are already created by the individual systems for the particular types of transactions in the real estate market. The analysis of the individual systems takes place on the basis of a consistent synopsis of issues, and the obtained responses, presented in the graphical form (with the use of maps of Europe).

recommendations made closely resemble those from 1991, immediately after the collapse of the system, as if the last 15 years and the mortgage loans worth PLN 130 billion, together with the entire experience and all legal reforms, did not take place at all.

#### **Growth dynamics of mortgage lending in Europe, 2007 to 2006.**

Country	Change 3Q 2007/3Q 2006
Belgium	7.9%
Denmark	9.1%
Germany	-2.0%
Estonia	42.1%
Greece	23.2%
Spain	16.2%
France	13.1%
Ireland	19%
Italy	11.2%
Latvia	42.1%
Lithuania	63.0%
Hungary	68.3%
Austria	15.0%
Poland	58.0%
Portugal	10.0%
UK	12.8%

Source: European Mortgage Federation

Therefore, the dynamics of development of mortgage loans is not the most important concern and challenge for the countries studied. As shown by the statistics, the CEE countries are the ones with the highest mortgage loan increases. Despite EBRD's conclusions, the mortgage collaterals used in the already existing systems (after reforms) are effective. This is confirmed by good quality of mortgage portfolios in the supervision assessment.

#### **4) General assessment of ownership traditions and difficulties with identification of real properties in the EBRD Report:**

As the basic conditions of the infrastructure crucial to the sense and existence of the mortgage business, the **report analyses the degree of private ownership and entering the possession of land and buildings into the registers.**

*"Private home ownership:*

- a) *„one of the keys to fostering economic prosperity, political stability and wider equality” + general statement that in central and.....*
- b) *Eastern Europe is a relatively recent phenomenon, principally as a result of the privatisation policies”.* EBRD, p. 4

- as regards this issue, EBRD assesses the 17 countries very differently. According to the authors the percentage of home ownerships exceeds 80% in only 9 countries (according to EFH, see footnote 2 on p. 6 of the EBRD Report);
- moreover, the report gives a notion – see quote on top of p. 4 of the EBRD Report - that **ownership is a new phenomenon in the countries studied, which has a clear impact on the ability of it being legally used for mortgage purposes;**
- the lack of tradition of dealing with real property ownership and the lack of entry and identification of properties in registers constitute serious reproaches of EBRD against the Polish system, constitute a significant problem in

establishing a mortgage security and, in the authors' opinion, increase the risk of mortgage financing (cf. the correction below);

**"Proof of ownership**

*Proof of ownership covers the following areas of certainty.*

*Certainty that the mortgagor has a mortgage able right in the property. A mortgage is an ancillary proprietary right that can only be given by the person with a principal proprietary right over the immovable asset which is most often established through title registration.*

*Certainty as to the scope of the mortgagor's property. Any dispute over the scope of the mortgaged property will adversely affect the role of the mortgage as a credit risk mitigant. Title registration is usually based on a cadastral definition which needs to be both accurate and reliable so that the risk of a subsequent dispute is minimised."*

*EBRD, p. 12*

*"The absence of a reliable source from which to establish a unique identification for a property can present a significant problem when creating a mortgage. In practice this arises where some land or buildings remain unregistered, as is still the case, for example, in Croatia, **Poland**, Romania, Russia and Serbia. "*

*EBRD, p. 14*

- According to EBRD, **as regards Poland**, similarly to Croatia, Romania, Russia, Serbia, the **lack of a credible source that can be used to identify a real property** can pose a serious problem to establishing a mortgage. This can be observed in practice if some of the land or buildings have not been registered - for instance, in Poland (cf. the correction below).

The above general summaries from which Poland, as one of the countries participating in the analysis, was not excluded, or the information directly referring to Poland must be **clearly rectified**. The remarks in this item refer to the issue of methodology as well as supplementation of or confrontation with the data - as well as the logic behind using these data to assess the risk of mortgage financing in the given market.

**CORRECTIONS of the EBRD Report conclusions:**

- **as regards ownership traditions and percentage share in the private home ownership market**, the cooperative form of home ownership was not taken into account here, although systemically and with respect to financing risks it is basically equivalent to the ownership right. In Poland this is not put into question, especially following the reform of 2005 which secured the mortgage creditor's legal certainty should cooperative ownership be converted into the ownership right. This reform, already completed in Poland, was omitted by the authors, and what needs to be clarified here is the information presented in the report that in Poland the share of private home ownership does not exceed 80% (p. 4 footnote 1 of the EBRD Report);
- the report also gives a notion – see the quote on p. 4 of the EBRD Report - that ownership is also a new phenomenon in Poland; according to EBRD: *"Private home ownership is a relatively recent phenomenon, principally as a result of the privatisation policies"*.

**Poland** definitely constitutes an exception to this rule, since **contrary to the Soviet policy of collectivism, the reform of nationalising** arable land did not take place. Strong attachment to home ownership as regards urban areas manifested itself in popularisation of cooperative ownership rights. **This was not a collective ownership** but a separate right to a flat – following the ownership model, it could also be mortgaged. The ownership title was and is being entered in the land and mortgage registers.

Also the “perpetual usufruct” – unique in Poland – entered in the land and mortgage register similarly to the cooperative right – could be encumbered, be subject to enforcement, and can be a fully economically valuable object of trade.

Therefore, the legal existence and access to the ownership right and comparable rights has been uninterrupted in Poland similarly to a mortgage for centuries. However, during the Socialist times the system and the economic needs significantly restricted their use, the legal instruments preserved their validity and continuity. This also applies to the mortgage law which, although it was separated from the Civil Code in the form of an Act, preserved its quality and functionality.

Also the land and mortgage registers were carefully stored all this time – temporarily entrusted to the care of public notaries (and now are back in courts).

The Polish system of legal infrastructure has, perhaps contrary the former states of the Soviet Union, a long-standing legal tradition with all the environment, which today pays off in the form of trade certainty and the system of collaterals on real property. This is also a helpful circumstance when solving re-privatisation claims since continuity of the records in the books and registers is a certain point of reference and, in effect, every case has a chance of being individually resolved.

- The EBRD Report erroneously indicates that Poland, similarly to several other countries mentioned in the report, has serious problems with identifying real properties because they are not entered in the registers.

#### **CORRECTIONS of the EBRD Report conclusions**

It should be pointed out that **as a matter of principle Poland has no practical problems with identifying real properties**, especially as regards legal designation of the building (due to the presumption that buildings are assigned to the land plot). This means that there are no separate registers of land and buildings (however, only perpetual usufruct must be paid attention to). In some countries lack of a *superficies solo credit* rule poses a problem and causes confusion with real property identification, which was generalised by the authors of the report as also present in Poland.

It is also true that not all real properties have land and mortgage registers (the reproach in the report refers to these registers) – **although contrary to what the authors believe, this has no impact on identification of real properties**. In Poland real properties are identified by examining land registers. Land plots having an economic value in Poland (maybe this is not a typical situation for post-Soviet republics) are measured and the cadastral data system has been uninterruptedly maintained even during the Socialist times.

The basic means of identifying the land is the cadastre – the land and mortgage register refers to these data, not covering them with positive guarantee (the land and building register is decisive).

A land and mortgage register is not maintained for every real property identified in the cadastre – this applies to properties which, for instance, were not the subject of trading or establishing the rights. Moreover, for some resources there are document collections – a former form of the present land and mortgage registers.

**However, the lack of a land and mortgage register poses no vital problem to determining the legal title to the property** as well as to establishing a mortgage. In practice – applications to establish a mortgage or to register the owner are filed together with the applications to establish a land and mortgage register. While the procedure is underway, a system of notes is in place, and the order is reserved in line with the time of filing the application.

#### **IV. Information about the accomplished reform of the mortgage law infrastructure in Poland that was omitted but which is important, especially for the comparative part of the report**

The image of the Polish market presented by EBRD in the report, for instance: based on the question: "Is the mortgage system credible?" (cf. composite tables) omits basic information about the reforms accomplished since 2000. The report presents the system as:

- being outdated,
- requiring fundamental reforms,
- burdened by a significant risk, unreliable,
- just recognising what private ownership and mortgage mean following the Socialist regime.

There is a misconception in the report that no reform has been carried out in Poland. The report formulates a number of already outdated recommendations, in effect it sheds a negative light on the credibility of the Polish mortgage system (cf. various composite tables presented in the report).

#### **The important achievements of the reform in Poland omitted in the EBRD Report include:**

- takeover of land and mortgage registers by the courts from State-owned Notary Public Offices, takeover of the responsibility by the State for their correctness and entries - 1991;
- abolition of a statutory mortgage constituting a secret encumbrance on real property - 2001;
- significant improvement of the mortgage position in satisfying claims in enforcement proceedings (limitation of payments for work that precede them, priority before taxes)- 2001;
- lower risk associated with financing cooperative flats (introduction of a rule that these rights do not expire in the event of an enforcement but are converted to ownership rights) - 2002;
- significant improvement of the mortgage creditor's position in bankruptcy proceedings (severability, improved order of satisfying debts secured by mortgage) - 2003;
- improved definition of the rules governing the use of a simplified procedure of mortgage establishing by banks (no need to draw up a notarial deed - lower costs) - 2002 - 2004;
- initiation of a comprehensive reform to computerise the land and mortgage register system - 2003;
- simplification of the system of court fees for entries into the land and mortgage register (fixed rates instead of proportional ones) - 2005;
- lower fees associated with mortgage lending (such as lower notarial and court fees) - 2005, 2007;

- facilitation and simplification of trading mortgage debts, for instance by reducing the fee for entries into the land and mortgage register and by enabling the use of bank documents to indicate the change of the creditor in the land and mortgage register - 2004, 2005;
- adaptation of mortgage collateral to market needs – introduction of a contractual joint mortgage (possibility to secure one debt on several properties, which makes it possible to use the property value to the maximum) – 2001;
- abolition of priority of satisfying compulsory mortgages securing tax debts (Tax Ordinance) – 2007;
- right to convert mortgage securities to mortgage bonds (act of June 29, 1995 on bonds), letters of lien (act of August 29, 1997 on letters of lien and mortgage banks), MBS (act of May 27, 2004 on investment funds – securitisation funds, amendments to the Banking Law of April 1, 2004 – possibility to securitise bank debts).

### **Good position of the mortgage creditor in the Polish system**

One should notice a huge **legislative breakthrough** that occurred in Poland in recent years as regards the **enforcement procedure** – contrary to the conclusions of the EBRD Report that this is one of the areas most neglected in the Polish legal infrastructure. Above all, what is worth noticing is the **abolition of the statutory mortgage** and other secret rights significantly increasing the risk, and **improvement of mortgage position in the enforcement procedure**.

The statutory mortgage used to secure the receivables of the State Treasury or a local government was established on the basis of special provisions by virtue of the law, without being entered in the land and mortgage register (hence it was “secret”) and it had a priority, except a few situation, in satisfying claims before other types of mortgage.

The statutory mortgage was abolished in June 2001. It was replaced by a compulsory mortgage regulated by the Tax Ordinance, which currently must be entered in the land and mortgage register for effective order of satisfaction of claims.

Receivables secured on a mortgage in the hierarchy of individual categories of receivables successively satisfied by the funds obtained through enforcement as indicated in article 1025 of the code of civil procedure were criticised until 2001. Mortgage debts were being satisfied in sixth place, preceded, among other things, by other taxes.

In result of subsequent amendments the order of satisfying mortgage receivables was significantly improved.

**At the present time debts secured by a mortgage are listed in the fifth place**, preceded only by enforcement costs (category 1), alimonies (category 2), receivables for work limited to 3 months and annuities (category 3), as well as receivables arising from debts secured by marine mortgage (category 4).

Receivables preceding a mortgage (alimonies, receivables for work, annuities, enforcement costs) belong to a category of the so-called privileged receivables by virtue of the law itself, other systems have analogical regulations. Hence, the statement found in the report that:

*“but the legal provisions specifically covering mortgage as security have been largely overlooked” [after the EBRD Report].*

The report also fails to notice the fact that the latest technologies have been used to computerise the land and mortgage registers (this is particularly relevant to the analysis, for instance, in Table 2 on p. 15 of the EBRD Report):

### **IT system of land and mortgage registers**

The purpose of **computerisation of the land and mortgage registers** is to facilitate, accelerate and extend access to information on real properties by obtaining an excerpt of the land and mortgage register without delay, possibility to obtain an excerpt of or to view each land and mortgage register already entered in the IT system from any place in Poland (facilitated access to information on real properties located in another region).

The subsequent land and mortgage register divisions in district courts throughout Poland are gradually covered by the electronic system. **As of February 2008, the electronic system covered 143 land and mortgage register divisions out of ca. 350 operating in Poland.** It should be added that courts in large municipal centres are covered by the IT system, e.g. it was introduced in all divisions of the Warsaw court.

In 2006, **3.2 million land and mortgage registers out of the total of 17.8 million** were maintained within the electronic system. By 25/02/2008, **44 land and mortgage register divisions were fully computerised**, i.e. all land and mortgage registers maintained by these divisions in the previous form have been copied into the land and mortgage register structure within the IT system and are found in the Central Information on Mortgage Registers.

Within the framework of the reform implemented in Poland, land and mortgage registers already maintained in the electronic form are entered in the so-called Central Information and **are available everywhere in Poland, regardless of location of the real property** and thus the court maintaining the land and mortgage register concerned. **Both viewing access to and an excerpt of the land and mortgage register can be obtained in each court covered by the electronic system** or at the central unit in Warsaw. An excerpt can be obtained on the spot or even by post. Although the so-called online access to the land and mortgage registers has not still been provided, but work on it is being conducted; the ministry of justice plans making the land and mortgage registers accessible via the Internet for all categories of users by 2010 (the respective amendment to the statutory legislation is planned by the ministry in 2008). In 2007, Poland was included into the EULIS+ programme.

Similarly, the reform of mortgage in enforcement and bankruptcy procedures is completely disregarded (cf. discussion of this reform in item VII.a of this document).

## V. Assessment of legal infrastructure change recommendations in the EBRD Report – their usefulness and effects for the mortgage market in Poland

**The objective of the EBRD Report** – in the authors' intention, this report is to fill the gap of the lack of a comprehensive and objective guidance on the basic issues of the legal frameworks of mortgage, necessary for implementing changes in countries undergoing reforms.

*"However, for the transition country that wants to modernise its legal framework for mortgage there is a lack of comprehensive and objective guidance on the basic issues involved. It is that gap that this work aims to fill."*

*Mortgages in transition economies, EBRD, p. 5*

EBRD recommendations are principally presented as 10 points "EBRD Core Principles for a Mortgage Law" (cf. Box 1 p. 11 of the EBRD Report) and as comments and assessment criteria to the composite tables contained in the report. Also the explanatory notes in Annex 3, p. 63 et seq. of the EBRD Report are worth noting.

### **The assessment of the EBRD recommendations should be commenced from the three principal notes:**

#### a. **Vagueness**

More detailed discussions of **the recommendations**, particularly of the "EBRD Core Principles for a Mortgage Law", remain so general that they are obviously consistent with the assumptions of good reform of each system. However, the usefulness of the recommendations in practice, at least in the case of Poland, is minimal due to the market development level and legal infrastructure far beyond the indicated "ABC".

The report definitely seems to repeat the recommendations formulated in 1991 – just after the Socialist system collapse, without adapting them to the introduced changes. Therefore, most of the recommendations are too perfunctory to inspire an actual reform project.

#### b. **Conflict with reality and tradition of the European system**

An additional difficulty associated with application of the recommendations is the fact that they are in conflict with and partially do not take into account the realities and traditions of the European systems, adopting as points of reference the Anglo-Saxon market and system practice. The report criticises, for example, rooting the mortgage law in the Roman law tradition and its embedding in doctrine, and the important role of court procedures.

#### c. **Risk of implementing EBRD recommendations and certainty of trade**

On the other hand, the EBRD recommendations of the type: "the registers should only register but not examine the rights", which is a proposal of abstaining from the positive warranty of the land and mortgage registers (cf. p. 23), would herald



revolution within the Polish system with effects difficult even to estimate as to the risk to certainty of trade.

In general, the package of the proposed reforms seems not to be commensurate to the current stage of development of the Polish mortgage market. The main reform in Poland has already been achieved, and also the further direction of reforms has been defined.

Currently, the real challenge is rather to **consequentially implement and ensure internal consistency** of application of the law – and many of the EBRD recommendations (such as eliminating positive warranty of the entries in the land and mortgage registers) do not promote this challenge.

*"The legal framework for mortgage is, however, looked at comprehensively. It is not just the law on the books, but it also includes the way the law is applied, the institutions that apply it and, ultimately, the result that is delivered. The starting point for our analysis is to look at what is needed to provide an efficient security instrument in the context of modern market practice (and predictions of future trends). Only then should the precedent of laws of countries with more advanced mortgage markets be examined. Most mortgage laws were designed a long time ago. Even where they have been adopted recently they are based on much older laws, but the mortgage markets of 2007 bear little relation to those of 50 or 100 years ago."*  
EBRD, p. 5

The above fragment contains a declaration of taking into account in the report the effective models for mortgage law implementation in practice. The authors rightly notice that the law is not only the entry in books but above all the method of application, the applying institutions and the results.

Unfortunately, this issue has not been more precisely discussed in the report in a manner referring to the actual practice needs – at least not for Poland.

## CONCERNS

- a. **Does EBRD rightly apply with respect to mortgage law assessment the similar approach and recommendations to those used previously for the security over movable property?**

*"The methodology used was similar to that of the EBRD Regional Survey of secured transactions, which covers security over movable property and was first published in 2000."*

*Mortgages in transition economies, EBRD, p. 5*

In the report, especially in the "regional survey" part, the same methodology was used as that applied by EBRD in the study in 2000 related to secured transactions and collaterals on movable property.

The Polish system intentionally differentiates between and separately regulates collaterals on real property and movable property. This is another difference as compared with the Anglo-Saxon model, and when a solution derogating from this traditional rule is used, special care should be applied so as not to weaken the mortgage institution.

- b. **Are the recommendations of changing the law disregarding the debtor's position possible to implement?**

An important default of the recommended reforms is taking into account by the report authors only the point of view and rights of the mortgage creditor to rapidly and effectively establish the mortgage, and then to potentially enforce it. Although this approach may be viable on condition of the subjective assessment of the

effectiveness of the creditor's right – as presented in the report – it seems that a change of this law and systemic reforms must, at least in the European conditions, take into account and balance also the position of the mortgage debtor. Mortgage as a right in property results in regulations both against the creditor as well as the debtor, and also against third parties. **Therefore, the reform recommendations should also similarly refer to the full package, and not as it is done in the report – in an isolated manner, with respect to only one party to the procedure.**

Otherwise, it is an illusion to conduct such reforms in democratic parliamentary procedures or as a result of unilateral lobbying, because then they would not be sustainable.

**Defining the rights of the mortgage debtor in an equilibrated manner is in most cases of the undertaken reforms the highest challenge** for their authors. Unfortunately, the report does not bring any helpful proposals of such solutions, formulating only very general postulates with which mortgage creditors obviously agree.

The report dissociates from this challenge which is indeed the most difficult issue to be balanced in the mortgage reforms – especially in view of the dynamically developing consumer law. Report and its recommendations adopt only the point of view and the functioning legal operation effectiveness in view of the **mortgage lender:**

*"Debtor need some degree of protection, but overprotection inevitably Leads to a reduction in availability of credit. **This publication does not attempt to address where the balance should be struck**"*

*Mortgages in transition economies, EBRD, p. 8*

### **3) EBRD Core Principles for mortgage law (EBRD Core Principles)**

- 1. A mortgage should reduce the risk of giving credit, leading to an increased availability of credit on improved terms.*
- 2. The law should enable the quick, cheap and simple creation of a proprietary security right without depriving the person giving the mortgage of the use of his property.*
- 3. If the secured debt is not paid the mortgage creditor should be able to have the mortgaged property realised and to have the proceeds applied towards satisfaction of his claim prior to other creditors.*
- 4. Enforcement procedures should enable prompt realisation at market value of the mortgaged property.*
- 5. The mortgage should continue to be effective and enforceable after the bankruptcy or insolvency of the person who has given it.*
- 6. The costs of taking, maintaining and enforcing a mortgage should be low.*
- 7. Mortgage should be available (a) over all types of immovable assets (b) to secure all types of debts and (c) between all types of person.*
- 8. There should be an effective means of publicising the existence of a mortgage.*
- 9. The law should establish rules governing competing rights of persons holding mortgages and other persons claiming rights in the mortgaged property.*
- 10. As far as possible the parties should be able to adapt a mortgage to the needs of their particular transaction."*

*Mortgages in transition economies, EBRD, p. 11*

**COMMENT/** remarks to the EBRD Core Principles:

The "EBRD Core Principles for Mortgage Law" take into account a number of rules, however, they disregard the fact that the mortgage law is to be not only quick, cheap and simple but should also guarantee the certainty of existence and incontrovertibility of the established security throughout the loan term.

The report authors clearly do not notice that in most of the countries studied the groundbreaking reforms have already been achieved (the basic 10 principles are met). Experience has been obtained in markets subjected to huge dynamics of development. Therefore, usually the actual problem is not how to reform but how to maintain the consistency and direction of the reforms, because it is a long-term process which requires continuous determination and financial outlays.

**4) FOUNDATION'S POSTULATES TO DEVELOP RECOMMENDATIONS ACTUALLY USEFUL FOR THE REFORM**

It would be extremely useful to deepen the analyses and to develop recommendations for solutions in the following areas, by making the description of "Core Principles" more precise:

- a. obtaining the desirable time of mortgage entry into the land and mortgage register:
  - organisation of work of courts; how to combine the ongoing computerisation reform and periodic migrations of the land and mortgage registers with the boom in the real estate market and an increase in the number of received cases for entry into or establishment of the land and mortgage registers – the logistics of processes in transformation countries, technical support, know-how for smooth management of resources of the land and mortgage registers during reforms (partially in the electronic form, partially in the paper form).
- b. obtaining high time rates and percent recoverability of mortgage in the enforcement process:
  - balancing the rights of mortgage creditors, limiting the rights to challenge and protract or block the procedure – developing a standard package of such rights at a level acceptable for the parties, indicating such "reasonable packages" (their total denial does not seem to be a pragmatic solution); increasing the efficiency and popularisation of processes of real property auctions – examples of electronic platforms and solutions, package of legal solutions combining court supervision with commerciality of the procedures.
- c. postulate of simplicity of creating the security:
  - in this case, in many countries solutions already exist or are being prepared to limit the accessory of mortgages. Usually, in addition to the traditionally accessory mortgage, alternative solutions of the type of land debt or Swiss Schuldbrief are being introduced – examples are Hungary, Slovenia, Estonia, the draft Act in Poland. The European concept of Eurohypothec is here a very helpful and constructive proposal. Unfortunately, the EBRD recommendations at this points should be interpreted negatively as to such a reform (its comprehensive nature is stipulated as its default), to the benefit of looking for simple ad hoc solutions everywhere where in view of a new transaction type the market reports such a need.

The report does not go into this level of examining the real issues and potential recommendations. At the same time, some of the recommended general directions would result in deviation from the already delineated path of ongoing changes (increasing the substantive law power of land and

mortgage registers, increasing the flexibility of accessory of mortgages, reform of court procedures at enforcement from the property or mortgage enforcement in bankruptcy).

## VI. Specific part of the report “Mortgage Regional Survey and comparative overview” – corrections

### Tables, scoreboards – corrections of facts, supplementations and remarks

As it has already been indicated in item I of this document, system quality assessment in the EBRD Report is negative, especially in such key points as **efficiency of mortgage registration and of mortgage security enforcement**.

The remarks below are to revise the conclusions cited from the point of view of only one country of those studied in the report – **Poland**. Although authors of the remarks do not have at their disposal a database with comparative information for other countries, which would make it possible to discuss the final comparative assessment, when analysing the published data and opinions on the Polish mortgage system we tried to share our views on the methodology and workshop of making comparisons, especially when on the basis of the noticed substantive defects of information we suspected that this may impair the reliability of individual conclusions of the study.

The analysis of the information database on the system existing in Poland presented in the report resulted in a number of remarks which were broken into the following categories:

- substantive corrections;
- supplementations with missing information significant for conclusions and assessments (especially when it was noticed that the specific issues are cited for other countries analysed);
- noting the precision and adequacy of methodology.

#### a. Table 2 Land registers – availability on the internet:

Table 2 Land registers – availability on the internet				
All basic information publicly available	Limited information publicly available	System under construction, not all information available	Information available to restricted persons	Not available
Czech Republic Estonia Hungary Latvia Lithuania	Ukraine*	Croatia Serbia Slovak Republic Slovenia		Bulgaria Georgia Kazakhstan Kyrgyz Republic Poland Romania Russia
England The Netherlands			Germany**	France

Notes: \* Mortgage Information is available but not title Information.

\*\* Only available to notary offices.

*Mortgages in transition economies. EBRD, p. 15*

**Remark as to the methodology:** inconsistency of the title (availability on the Internet) with its actual content which is more relevant for the issue of whether there is a right to view the content of (public access to) the land and mortgage register is visible in construction of this Table.

Due to the lack of this consistency, non-comparability of the results is possible. Information on entries may be publicly available: in full, to a limited extent, to specific persons, not available. Indeed, the lack online access via the Internet does not exclude a positive answer to a question about Internet access to the content of the land and mortgage registers – various solutions exist, allowing attainment of this objective, guaranteed within the legal systems.

## CORRECTIONS of EBRD conclusions

With respect to Poland, the report gives the information on the lack of access to the land and mortgage registers via Internet. Moreover, Poland is not included in the group of countries where improving reforms are undertaken, although the Table provides for the category of systems under construction (cf. Information on reforms in Poland – item III.4. of this document).

*"Some countries have found pragmatic solutions to facilitate mortgage transactions pending improvements in land registers, for instance in Ukraine (see Box 2), and in Croatia where a mortgage can be created over a property not yet registered in the land register."*

*Mortgages in transition economies. EBRD, p. 16*

The reforms achieved in Poland were not taken into account in a similar manner. In fact, in Poland full public access to the contents of the land and mortgage register is provided, also via the Internet in the computerised part (through the agencies operating at land and mortgage register divisions).

### b. Mortgage creation and transfer – EBRD presents a disparate approach to mortgage accessory, reversing the effects of reforms:

#### **"c. Accessory – should the mortgage be accessory to the secured debt?"**

*Accessory is often cited as a curb on flexibility for mortgage creation and as an obstacle to the transfer of mortgage. These problems, in fact, do not come from the concept of accessory, which is self-evident: a mortgage always depends on the existence of a debt secured by a property, and in the absence of a secured debt a mortgage creditor can exercise no rights under it. In that sense there is no such thing as a "non-accessory mortgage". While there is general agreement that the secured debt has to exist and be defined with adequate certainty for a mortgage to be enforced, requirements for the debt also to be in existence and/or specified at the time of mortgage creation vary considerably from one country to the next. Difficulties often arise from the way in which in some jurisdictions the so-called "doctrine of accessory" is applied. The requirements that result from such a doctrine can limit the kind of transactions that can be secured by mortgage and the way they can be structured."*

*Mortgages in transition economies. EBRD, p. 18*

For the assessment of accessory effects, the authors adopted inadequate assumptions as to the meaning of this term (at least with respect to the Polish legal system).

The authors assume that non-accessory means the absence of linking a debt to the security, which would give to the creditors the right to pursue their claims from the mortgage whether it exists or not.

Further, the report authors claim that in this sense there is no such thing as a non-accessory right (in EBRD's opinion, it is rather a fabrication of interpretation)

*"In that sense there is no such thing as a "non-accessory mortgage".*

*Mortgages in transition economies. EBRD, p. 18*

The EBRD authors attribute difficulties with accessory to the doctrine of accessory and not to the law itself.

*"Difficulties often arise from the way in which in some jurisdictions the so-called "doctrine of accessory" is applied."*

*Mortgages in transition economies. EBRD, p. 18*

They cite the **German example of "Grundschuld"** as an illustration of an abstract security right: *"since it is created as an abstract security right" (EBRD, p. 18).*

The report authors do not see a link between the accessory of mortgage and the possibility of flexible loan transfer with mortgage.

As a result, the EBRD recommendation comes down to the postulate of regulating the transfer of mortgage debts, especially for securitisation transactions. In EBRD's opinion, after this postulate is met, any advantage of non-accessory of mortgage rights ceases to be of any relevance for the problem of flexible security transfer.

*"If they do so, any advantage of the non accessory mortgage on transfer falls away".*

*Mortgages in transition economies. EBRD, p. 18*

Therefore, the discussion on accessory ongoing in various jurisdictions, which *"leads to crossed wires"*<sup>6</sup> and – as it seems – is incomprehensible for the report authors, should be abandoned, because *"it becomes clear that the advantages of non-accessory may be illusory"*<sup>7</sup>.

## CORRECTIONS

Recognising the importance of the report and its goal to present recommendations influencing the mortgage reform in 17 countries covered by the study, we consider it extremely important to adopt the following corrections. Indeed, the EBRD recommendation to regulate the transfer of mortgages only for particular transaction categories (e.g. for securitisation purposes) with concomitant abandonment of measures to increase the flexibility of accessory of mortgage rights is in conflict with the reforms which are now quite advanced in many countries (would negatively interfere with such reforms) and what is more, in such a simplified version this recommendation would not lead to an effective solving of the problem of mortgage transfer even for the narrow purpose of securitisation, contrary to the assumptions of its authors.

The issue of mortgage flexibility must be definitely solved by a change in the law and not by a change in judges' views, as recommended by EBRD.

Remarks to the subsequent opinions from the report:

Contrary to the views expressed in the report, mortgage accessory does not arise from the doctrine. It is based on precise regulations – in the case of Poland, Article 79 (1) of the Act on Land and Mortgage Registers and

<sup>6</sup> "Any discussion.. leads to crossed wires", *Mortgages in transition economies. EBRD, p. 18*

<sup>7</sup> "But when the issues surrounding accessory are looked at detached from any specific legal system and are analysed in the context of the practical effect they may have on a mortgage transaction it becomes clear that the advantages of non-accessory may be illusory." *Mortgages in transition economies. EBRD, p. 20*

Mortgage: "Debt secured by mortgage cannot be transferred without the mortgage, unless the Act provides otherwise".

**Therefore, contrary to what the report authors claim, there is a strict link between accessority and flexible transfer of mortgage debt without the security and vice versa.**

The **doctrine** in the legal orders of the European system criticised in the EBRD Report plays indeed a very important role for interpretation and operation of the law (similarly to the case-by law system, it ensures predictability, safety and certainty of application of the law). Contrary to the authors' wishes, it is impossible to eliminate this many centuries' tradition in order to obtain pragmatic and simple solutions to the issue of mortgage transfer. Therefore, the **reforms deviating from strict accessority of mortgages are not simple** – they include many areas of the law related to the accessority regulation – including the method of establishing the right, transfer, enforcement, land and mortgage register procedures (separate issue of registration or non-registration of a new mortgage creditor in the land and mortgage register), fees, role of the notary and, of course, the necessity to make amendments in the fundamental bases of the law– i.e. in the Civil Code.

However, only a consistent reform will guarantee the effectiveness of the new, more flexible solutions. Obviously, if this goal is to be attained, a consensus of the legislation, practice and doctrine is mandatory. Indeed, as shown by the practice, all ad-hoc solutions, with a selective approach to the specific transaction type, still bear some legal risk, because they are separated from the wider context of the law and direct market development to the privileged area, which does not necessarily agree with rationality of economic behaviours.

Therefore, it seems a justified assumption that, contrary to the EBRD's approach, more logistic and intellectual effort should be devoted to the real reform instead to spectacular ad-hoc solutions whose effectiveness is illusory in the reality of the continental law.

**We hope to convince EBRD to change the recommendation undervaluing the reforms for the benefit of increasing the flexibility of accessority of mortgages. In fact, these are reforms of fundamental importance for the development of the secondary mortgage market.**



c. **Table 3. Notarial involvement in the creation of mortgage:**

<b>Table 3 Notarial involvement in the creation of mortgage</b>			
<b>Notarial deed required</b>	<b>Notarial deed used in practice</b>	<b>Other compulsory notarial involvement*</b>	<b>No notarial involvement</b>
Bulgaria Estonia Georgia Kyrgyz Republic Lithuania Poland** Romania	Croatia Hungary Slovenia	Czech Republic Latvia Ukraine	Kazakhstan Russia Serbia*** Slovak Republic
France The Netherlands	Germany		

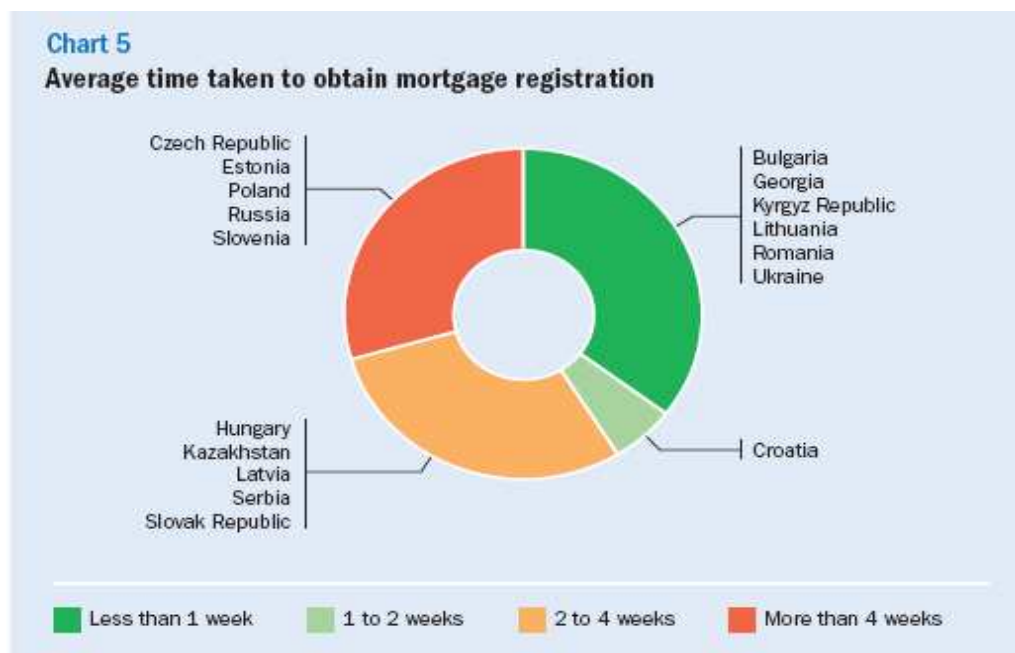
Notes: \* Usually signature certification  
\*\* Not required when the mortgage creditor is a bank  
\*\*\* Signature certification must be done at the court

*Mortgages in transition economies. EBRD, p. 21*

**CORRECTIONS TO TABLE 3**

It is rightly remarked in the Table note that notarial involvement is not required in Poland when the mortgage is created for a bank. However, since the report concerns mainly the operation of mortgages in the banking market, **we would suggest placing Poland in the context consistent with the practice – in column 2 or 4** with an explanation that the notarial form is used when the mortgage is not created for a bank. The basis for the practice in Poland is the so-called bank mortgage without notary involvement.

d. **Chart 5 concerning the time taken to obtain mortgage registration (EBRD recommendation of narrow understanding of the purpose and verification of registration):**



*Mortgages in transition economies. EBRD, p. 22*

- CORRECTIONS TO TABLE 5

**In the case of Poland – in accordance with the EBRD criteria – the time should be counted to the moment of disclosure of the note on mortgage (first category: *less than 1 week*) and not to the full entry**

- Disparate approach of EBRD authors and respondents to the question on the average time taken to obtain mortgage registration

The authors explain how the aim and effect of mortgage registration should be understood.

*"The aim of registering a mortgage is therefore to confirm to the world the validity of the mortgage in the same way as title registration confirms a transfer of land title. This approach derives from the principle that any person should be able to rely on the accuracy of information shown in the land register."*

*Mortgages in transition economies. EBRD, p. 22*

**Therefore, ensuring the following effect is recommended by EBRD and sufficient for registration:**

- **first, to alert third parties that a mortgage exists, or is claimed to exist;**
- **secondly, to establish the precise time from which it would have priority.**

Further, the authors explain that validity of the mortgage is a matter for the mortgage creditor who should be able to prove the validity of the mortgagor's title to the property, the validity of the title to the property and the validity of the credit agreement itself. When the mortgage is enforced, questions as to its validity can nevertheless be raised.

Therefore, EBRD recommends that when entering the mortgage into the land and mortgage register, "requiring the registrar or any other external to examine and be satisfied with the validity of every mortgage that is to be registered is placing a heavy and unnecessary burden on him that delays mortgage creation and is of little or no value to the parties or the public".

*"The case for the land register providing the public with guaranteed information on ownership of land is unquestionable, but the position for mortgage is different. **The desired effects of registration of mortgage are:** first, to alert third parties that a mortgage exists, or is claimed to exist; secondly, to establish the precise time from which it would have priority."*

*Mortgages in transition economies. EBRD, p. 22*

## COMMENT/ REFERENCE TO THE POLISH SYSTEM

Referring to the analysis of the Polish system and mortgage registration practice it should be mentioned that the specified aim of and postulates for mortgage security registration in the land and mortgage registers **are met by the institution of note** on the registered mortgage.

The possibility and content of the notes on the specific rights in the land and mortgage register is strictly regulated.

The note is registered and visible in the content of the land and mortgage register, also in the excerpts of the land and mortgage register made available on request.

### **The effect of the Polish "note" is the same as the aim stated by EBRD as the mortgage registration criterion:**

#### First:

- warning for third parties that there is a mortgage encumbrance claim to the particular real property.

This action is envisaged in the provision of Article 8 of the Act on Land and Mortgage Registers and Mortgage stating that the note on a submitted request excludes the warranty – and thus nobody can claim making a real property-related transaction being convinced that it is free of encumbrances.

#### Second:

- note on mortgage establishes very precise (up to one second in accordance with Polish regulations) priority of rights, in particular when other mortgages exist.

This action is envisaged in the provision that determination of mortgage order of priority is determined retrospectively to the moment of filing the request for entry.

Therefore, from the point of view of the EBRD criteria, making entries mortgages in the land and mortgage register might as a matter of principle end with registration at the stage described. Indeed, the functions of the procedure following note entry are, in the EBRD's opinion, obtaining the effect of mortgage authentication, irrelevant for third parties. For this purpose additional in-depth verification procedures are conducted.

## EBRD RECOMMENDATION

**EBRD recommendation is to narrow down the requirements at registration** to those which are necessary to achieve the intended effect (cf. above), i.e. to publicise the claim of the mortgagor that he has encumbered the real property with mortgage – and then the registrar has only to:

- a) check that the mortgagor is registered as owner of the mortgaged property;
- b) check that the person requesting registration is the mortgagor (*mortgagor* – mortgage debtor);
- c) ensure the information relating to the mortgage in the register accurately reflects the information given by the person who requested registration.

*"The process for registration should be designed to be simple and rapid. The requirements should be limited to what is necessary to achieve the intended effect. If, as in most traditional systems, registration is intended to "authenticate" the mortgage the process will be more onerous because the registrar will have to be satisfied either by his own enquiry or by relying on notarization that the mortgage has been validly created. If, as explained above, registration is merely intended to publicise the claim of the mortgagor that he has created a mortgage, the registrar has only to:*

*- check that the mortgagor is registered as owner of the mortgaged property (see Part III 3.2 b.)*

*- check that the person requesting registration is the mortgagor or a person duly authorised by him*

*- ensure the information relating to the mortgage in the register accurately reflects the information given by the person who requested registration."*

*Mortgages in transition economies. EBRD, p. 22*

## POLISH SOLUTIONS

**In accordance with Polish procedures and practice, all these three actions are performed already at the stage of registering the request for entry**, the first effect of which will be the note in the land and mortgage register. At this moment, the documentation associated with mortgage creation contains:

- Ad. a)** an excerpt of the land and mortgage register finding who is the disclosed owner, in accordance with the good banking practice – also the notarial deed, other purchase title, additional declarations of the owner;
- Ad. b)** in the Polish system no doubt arises whether the mortgage requestor is the mortgage debtor because it is usually the bank – the mortgage creditor – which files the mortgage request. However, even if the request is filed by the debtor (borrower) himself, in practice the above doubt will also not arise (consistent determination of identity of the mortgage requestor with the debtor under the loan agreement and the real property owner disclosed in the land and mortgage register or ownership-transferring notarial deed).
- Ad. c)** similarly as in b), in view of the regulatory provisions reserving the active role of the bank or notary, there is no risk of discrepancies in the information contained in the request.

## CORRECTIONS OF EBRD CONCLUSIONS (Chart 5 p. 22 of the report) CONCERNING THE REGISTRATION TIME

Therefore, Chart no. 5 should include Poland in the group of countries where the time of waiting for mortgage registration is **less than 1 week!**

The system of land and mortgage registers and mortgages in Poland uses the criteria of entry and checking its bases – **fully in the area not recommended by EBRD**. The substantive

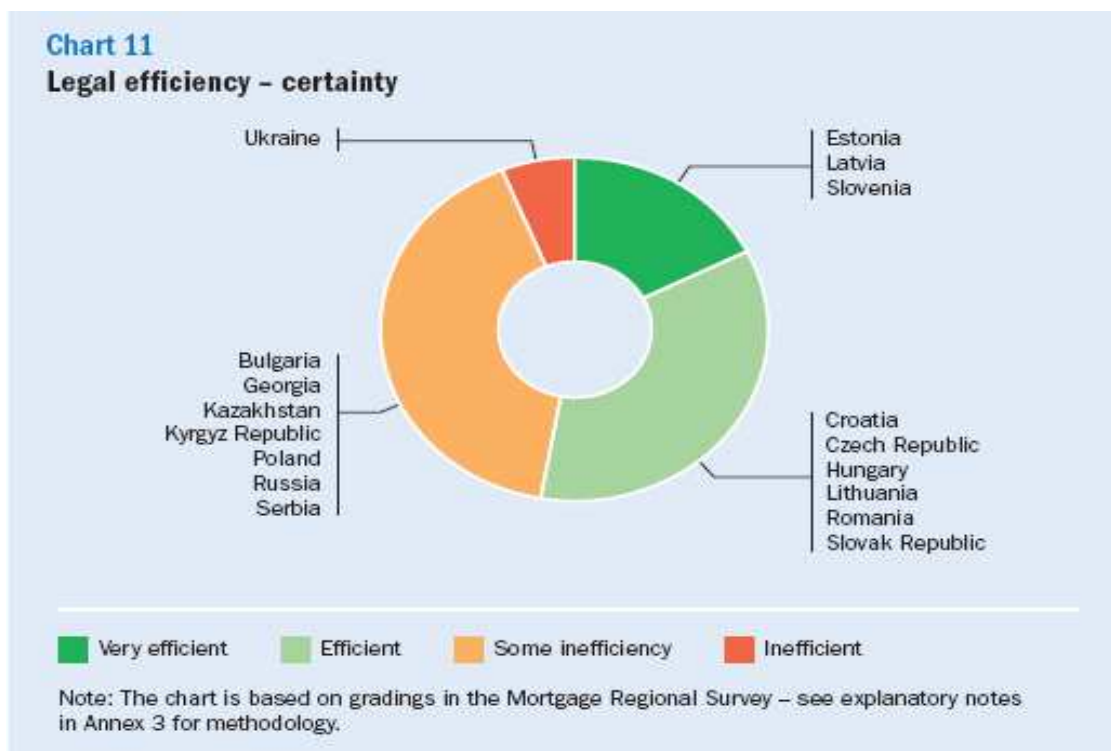
law bases of entries, the nature of the debts, the legal titles of real property purchase, etc., are examined in particular.

The final entry is an act of the court decision – i.e. a court decision on mortgage registration.

As a result, it is the State – the common judiciary which is responsible for the correctness of the rights disclosed in the land and mortgage register, in particular property encumbrances, including the liability for damages in the case of mistakes and errors.

The EBRD Report rightly mentions that high standards of substantive requirements for analysing the requests in mortgage registration procedures prolong the time and arduousness of the procedures, but a huge **misunderstanding is considering this fact in the aspect of a reproach as to the certainty of mortgage creation.**

e. **Chart 11 Certainty – legal efficiency of mortgage (EBRD recommendation to abstain from the positive warranty of the land and mortgage registers)**



*Mortgages in transition economies. EBRD, p. 38*

Poland was classified here to the third of four categories – as having some inefficiency, among the categories of very efficient, efficient, some inefficiency, inefficiency. However, as the authors do not give any justification, it is difficult to comment on this finding.

An issue examined at this place is whether there are problems with determining whether mortgage or other security rights are created on the real property.

In the comments, when summarising the safety assessment, the authors **exclude Poland** from the positively assessed countries of Central Europe which are characterised by higher certainty than the countries located farther to the East – **as a negative example of the lack of such mortgage safety.**

**The EBRD Report indicates also France and Germany as negative examples of mortgage certainty: "In France and Germany, a third party who wants to determine whether a property is mortgaged faces considerable difficulties" (EBRD).**

Furthermore, the issue of debtor obstruction to enforcement procedure is examined. In this case, Poland and Georgia were assessed as the worst.

*"In Ukraine lenders are concerned by a law designed to protect families with children, which makes eviction subject to approval from the Ministry of Youth Affairs. Mortgage loans are sometimes made conditional on receipt of such administrative approval, which can involve a lengthy procedure without predictable results, (...)*

***In France and Germany**, a third party who wants to determine whether a property is mortgaged faces considerable difficulties (...)*

*The situation is shown to be **worst in Georgia and Poland**, followed by Russia and Ukraine. In Russia debtors often apply for postponement, which can be granted by a court for a period of up to one year. A similar right to apply for postponement exists in Kazakhstan. In Georgia, the mortgagor and dependants are legally allowed after realization to remain in the property if they choose to do so as tenants of the property purchaser."*

*Mortgages in transition economies. EBRD, p. 37*

#### **COMMENT/ REMARKS OF THE FOUNDATION:**

- **The EBRD Report does not fully appreciate the practical importance of positive warranty of the land and mortgage registers maintained by courts and it uses the criteria of mortgage reliability assessment unsuitable for the for Polish system.**

**Importance of warranty:** In accordance with Article 5 of the Act on the Land and Mortgage Registers and Mortgage, in the case of inconsistency between the legal status of real property disclosed in the land and mortgage register and the actual legal status, the content of the land and mortgage register is decisive for the benefit of whoever acquired ownership or another property right (warranty of public faith of the land and mortgage registers) through a legal act with the person authorised on the basis of the content of the land and mortgage register.

Although before registration, the court may return to the requestor the request for mortgage registration for supplementations or may reject it, which protracts the registration procedure, but in view of the safety of mortgage creation and its content it is an additional procedural "safety device". Owing to this if the right is already entered, third parties not only can fully rely on the content of the land and mortgage register but may also derive legal effects from this information – the warranty rule.

Warranty of public faith and presumptions based on the land and mortgage register essentially eliminate the legal risks of mortgage certainty, sustainability and suability.

In the systems where entries are made more speedily but "mechanically", the potential errors are embedded in the land and mortgage register throughout the time of existence of the security and throughout the lending period, creating the potential risk of filing complaints when realising the mortgage in enforcement or bankruptcy procedure. The report authors consider that this risk must be accounted for. However, the Polish system tries to eliminate these risks already at registration.

A significant issue is also the liability for common typing errors and mistakes, which may occur in each registration system.

*"It has been seen that in practice this is not necessary. Leaving the onus of proving validity on the creditor who seeks to enforce simplifies the process for creating the mortgage and reduces time and costs. The mortgage creditor (and any person to whom the mortgage right is transferred) should **be capable of ensuring that the mortgage is valid without having to rely on the registrar**, and third parties only need to know whether a mortgage is claimed on the property.*

*A person searching the register does, however, need to rely on the fact that no mortgage can be claimed on the property other than those shown in the register."*

*Mortgages in transition economies. EBRD, p. 23*

In accordance with the above citation, EBRD denies the sense of existence of the positive warranty of entries in the land and mortgage registers; it is sufficient that "a person searching the register does, however, need to rely on the fact that no mortgage can be claimed on the property other than those shown in the register" (EBRD).

On the other hand, mortgage creditors should be able to prove that the mortgage is valid OTHERWISE than by relying on registration in the land and mortgage register.

- **The EBRD recommendation disregards the effect of registration cost increase.** When recommending the abandonment of warranty by courts and land and mortgage registers as to mortgage existence, the EBRD Report does not take into account its economic effects and costs. Reducing the role of the land and mortgage registers to a system of only registering the entries without any responsibility means that both for determining who is the real property owner as well as for mortgage existence it would be necessary to "put into operation" a system of legal offices which would issue the respective attestations (as legal titles in the USA). This would involve additional time and costs – disproportionately higher than the current fees for mortgage registration<sup>8</sup>. Within the systems of simple and only formal registration the researchers examining this issue, when asking about the mortgage registration time, should ask the question about what are the time and cost of compiling the respective documents for registration or determining ownership of real property.

#### **The EBRD's assessment of "mortgage certainty" for Poland disregards the additional asset of debt presumption.**

In Poland, debt existence presumption exists – perhaps not widely known to the systems studied by EBRD. Creating ordinary mortgage establishes the presumption that the debt exists (including the interest). **This is of fundamental importance for the burden of proof** if the debtor would like to deny the fact or level of his loan debt. It would be the debtor who would have to file the request/claim, bear the costs of the procedure – this state of facts protects against actions hampering and delaying the procedure by the debtor in enforcement proceedings or during the loan relationship – for example in the case of the risk of various consumer complaints.

Furthermore, the presumption of debt existence along with the public faith warranty of the land and mortgage registers create the fullest model guaranteeing the position of the mortgage creditor – without additional costs and the need to additionally evidence this in the enforcement process.

<sup>8</sup> The current fee for entry into the land and mortgage register in Poland is PLN 200 – ca. EUR 60 (lump-sum fee).

## **SUMMARY**

To sum up, it seems that the Polish system makes the mortgage fully reliable owing to the public positive warranty of the land and mortgage registers and to presumptions. At the same time, it is a system which is effective in the aspect of low costs and the possibility to ultimately rely as to the legal status of the real property on the content/excerpt of the land and mortgage register – without additional intermediation of out-of-court legal offices.



## VII. Regional analysis and comparative review of mortgages (Annex 2 p. 58 of the EBRD Report)

- **Idea of comparisons according to EBRD Report authors – methodological concerns**

The questions preceding the EBRD Report, in accordance with which the comparisons are made, address simple practical issues – they indicate the strengths and weaknesses of the mortgage security regime in individual countries – in a way that is to be useful for credit providers and their advisors – with respect to assessing the potential value of mortgage security.

The criteria for determining what is the strength and what is the weakness result from the “EBRD Core Principles for a Mortgage Law” (Annex 1) – cf. also item V. of this document.

The EBRD authors themselves emphasise that their aim is to assess the indicators of strengths and weaknesses of the system as such, not to provide a comprehensive assessment. “The information covered by the survey is not comprehensive enough to provide a full assessment” – especially for measuring the consistency with the context. However, the authors claim that the results provide sufficient information on what has been achieved in the specific country. The methodology of studies in the EBRD Report is based on the similar one previously applied with respect to movable property.

The respective citations from the EBRD Report:

*“The MRS (Mortgage Regional Survey) has been developed in a similar manner to the regional survey of security over movable and intangible property, which was first published in 2000.”*

*Mortgages in transition economies. EBRD, p. 32*

*“The questions address simple practical issues that highlight the strengths and weaknesses of the mortgage regime in each country in a way that may also be useful to credit providers and their advisers when assessing the potential value of mortgage security. The MRS composite table is set out in Annex 2. It is the most convenient tool to consult when wanting to know the answers received on a particular question related to mortgage law, and the respective strengths and weaknesses of transition economies covered. (...)*

*The questions in the survey are inspired more by market reality than legal theory. Based on the EBRD Core Principles for a Mortgage Law (see Annex 1), the survey covers four main areas of mortgage (creation, commercial effectiveness, effect on third parties and enforcement) and gives a reasonable indication of the extent to which these principles are upheld.(...)*

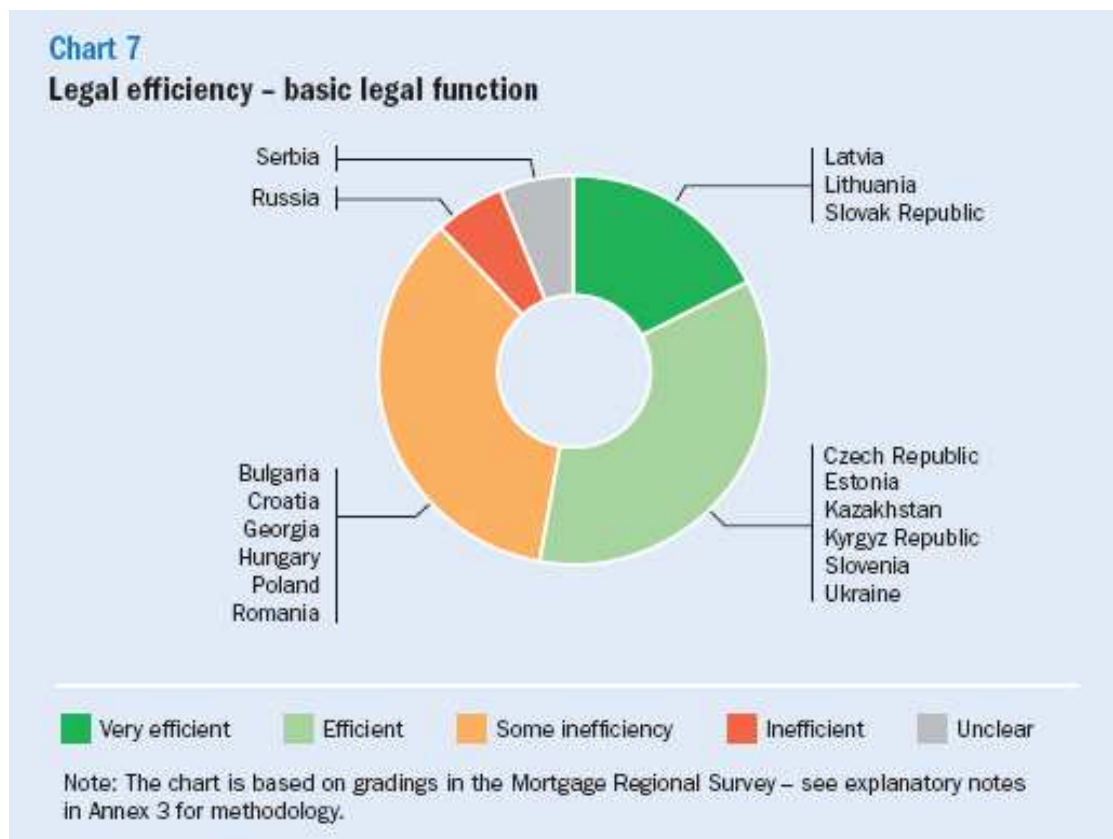
*For each criterion the survey grades have been used to indicate the relative efficiency of each country – there are four levels ranging from a clear yes to a definite no. We emphasise that these are intended as indicators of strengths and weaknesses, not as a comprehensive assessment.*

*The information covered by the survey is not comprehensive enough to provide a full assessment (especially for measuring fit-to-context) and a number of questions are relevant to more than one criterion. However, the results do provide a fair indication of what has been achieved in each country and useful pointers to what needs to be improved.”*

*Mortgages in transition economies. EBRD, p. 32*

For the assessment of composite tables – Annex 2 p. 58 EBRD, the remarks and objections as to the approach and methodology, presented in items I and IV of this document, remain valid.

a. **Table 7 Legal efficiency – basic legal function:**



*Mortgages in transition economies. EBRD p. 33*

**The basic legal function of the Polish mortgage was assessed in the category of “some inefficiency”.**

**COMMENT:**

However, there are no indications as to why Poland was rated at this level – the study does not use any data, statistics, references to legal regulations and, as summarised by the authors themselves:

*“Information was derived from local practitioners and is to a large extent **impressionistic** since hard statistics are not available. (...)*

*The Serbian Law on Mortgage, adopted in 2005, provides a complete new system of mortgage enforcement, clearly aimed at making the process more efficient, but there is not enough practical experience to be able to assess its results.”*

*Mortgages in transition economies. EBRD, p. 34*

**The information supporting the assessment was derived from local practitioners and it is essentially impressionistic and based on personal assessment** because some statistics are not available.

As to the Polish market, the following information implying negative grading is specified:

- enforcement has to be carried out through the courts (EBRD recommendations prefer the out-of-court path), “where enforcement has to be carried out through the courts there may be uncertainties concerning court procedure and practice” (after EBRD).

**This point of view is somewhat peculiar, as it is the courts which are considered to enhance the certainty of law enforcement.** Anyway, the factor of including the courts in the process of mortgage enforcement or creation is treated in many places in the report as a factor which increases as a matter of principle the uncertainty of the law.

Furthermore, **the procedures in Poland are reproached for privileging the wages claims. The authors seem to emphasise this risk more than tax privileges and other such hidden encumbrances.**

### **CORRECTIONS TO CHART 7 AS TO THE HIGH POSITION OF THE MORTGAGE CREDITOR IN POLAND:**

However, **the position of the mortgage creditor in Poland** is very high, both in the enforcement as well as bankruptcy proceedings.

The order of priority in satisfying the claims in enforcement proceeding in Poland is as follows:

- 1) enforcement costs;
- 2) alimony dues;
- 3) amounts due for work to a limited extent (for a period of 3 months up to the minimum wage level) and disability benefits and costs of ordinary funeral of the debtor;
- 4) amounts due under debts secured by marine mortgage;
- 5) amounts due secured by mortgage or registered pledge.

Already several years ago the issue of bankruptcy was regulated anew in the Act – Bankruptcy and Rehabilitation Law of 28 February 2003 (Journal of Laws of 2003 No. 60, item 535, as amended), which replaced the existing standards in this area. The Act, which entered into effect on 1 October 2003, significantly reinforced the legal position of the mortgage creditor.

The new Bankruptcy Law has introduced a number of significant changes increasing the reliability of mortgage security (above all meets the postulate of satisfying mortgage creditors not from the general estate in bankruptcy but from the secured object, i.e. the real property). This translates to a lower banking risk for mortgage lending.

The regulations in force in Poland – the following positive aspects are disregarded in the EBRD Report:

The new Bankruptcy Law has introduced a positive principle:

- the funds obtained from the sale of mortgaged real properties (reduced by costs related to real property sale) are first used for repaying the mortgage creditors (“severability law”);
- division takes place on the basis of the order of entries: “older” mortgages are realised first;
- the order of satisfying mortgage creditors was significantly improved (on the basis of a separate procedure, before taxes and the State Social Security Institution – ZUS);
- parts of the debt not repaid within a separate procedure have still a chance to be repaid from the general estate.

The order of priority in satisfying the amounts due in bankruptcy proceedings (within a separate procedure) is as follows:

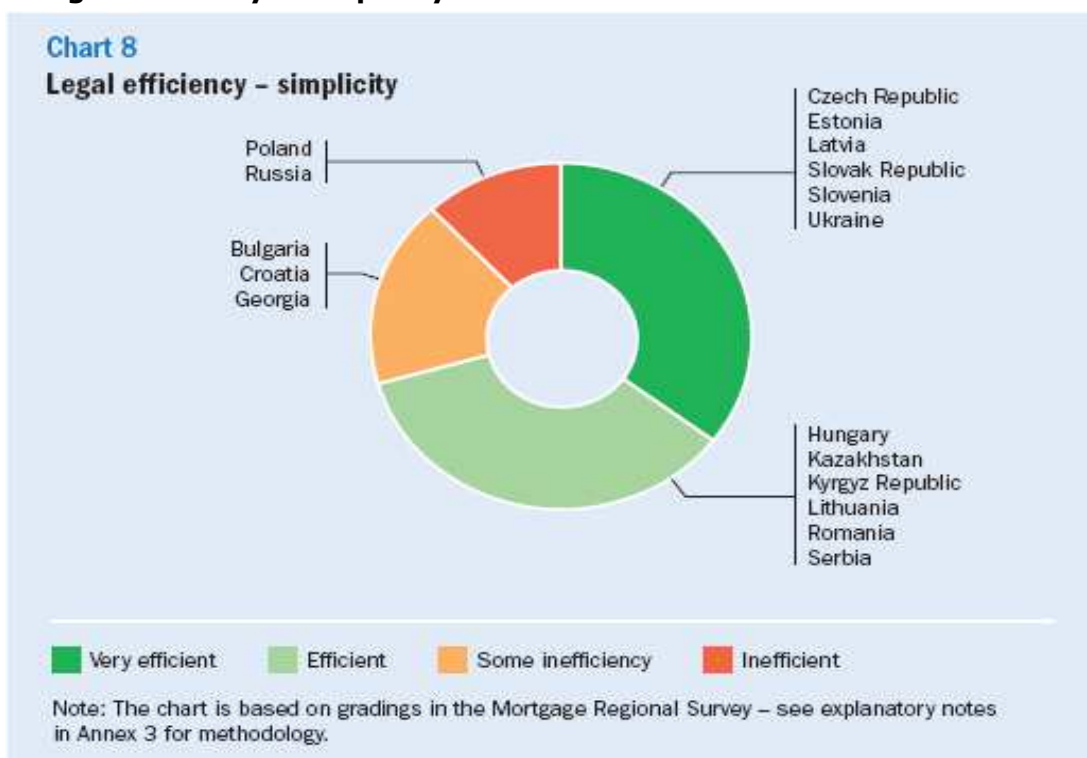
- 1) sale-related costs;
- 2) alimony dues;
- 3) amounts due for work to a limited extent (amounts due to employees working on the sold real property for a period of the last three months before the day of such sale, up to three times the minimum remuneration for work) and disability benefits;
- 4) amounts due secured by mortgage.

**Apparently, the authors did not notice this reform at all.**

The fact is that in view of good quality and young portfolio of loans the results of the reform have still not been proven in practice, but it is rather difficult to reproach it in the context of system adequacy assessment.

As to the level of recoverability with respect to the market price, a marginal market sample of such proceedings does not allow to determine any reliable statistics. However if the point of departure for the report is practice assessment, then it should be added that the solution which is definitely preferred in practice is cashing the security through an arrangement with the borrower – without court involvement. Here the effects are closer to full repayment of the debt. If the report examines the practice and not the “*law in books*”, it should take into account this fact. (No question adequate to this issue was asked in the EBRD surveys.)

b. **Chart 8 Legal efficiency – simplicity:**



*Mortgages in transition economies.* EBRD p. 35

## CORRECTIONS TO CHART 8

The Polish system is reproached the use of two types of mortgages: ordinary and maximum ones, which in the EBRD's opinion makes the procedures more complicated. **This is the most critically discussed reproach against the Polish system.**

Meanwhile, the existence of two types of mortgages for flexible use – although in the future it may be replaced by one non-accessory security – does not currently create any problem in professional trade to the scale indicated by EBRD.

- **Two types of collaterals: more and less accessory ones are the European standard; the EBRD authors are not right in considering a negative factor interfering with system effectiveness.**

The Polish market practice, particularly in professional trade – bank mortgages – does not pose any difficulties in this area. The documentation and request are prepared by a bank or notary; indeed, some professionalism and knowledge of the Polish law are required, but this does not constitute any obstacle.

In particular, there is some case law which confirms the safety of use of capped mortgage for variable-interest loans, covering also the debt or only interest.

It is a particularity of the Polish market, but when proper care is applied and the regulations are known, this issue does not have the importance attributed to it by EBRD experts.

Various types of mortgages existing also in other European systems are the effect of increasing the flexibility of the security right. The necessity of such diversification will disappear after the non-accessory right is introduced. In Poland the preparations for the respective reform are now ongoing (draft Act on land debt, other drafts to modernise the mortgage).

The registration forms contribute to increased simplicity – they are standardised, include a completion instruction and are provided both for traditional as well as for electronic registers.

- **EBRD's reference to Poland disregards the so-called "bank mortgage", although its use is typical practice:**

The report authors highly appreciate the possibility of efficient obtaining the court title confirming the borrower's default and thus shortening the time of enforcement. Poland is not contained in the list of countries assessed positively in this aspect. Presumably, the report authors were not aware of the fact that in Poland, banks have a privilege of issuing their own special executory titles (bank executory title, Articles 96-98 of the Banking Law). This right **simplifies pursuing of the claims since it excludes the phase of committal proceedings before the court**, enabling the bank to avoid the necessity to bring action against debtors for adjudicating the pursued claim by court decision constituting the executory title. Therefore, the privilege of issuing the bank executory title **allows saving time**, and all delays are associated with a risk of loss or reduction of the value of security as a result of illegal actions of the debtor.

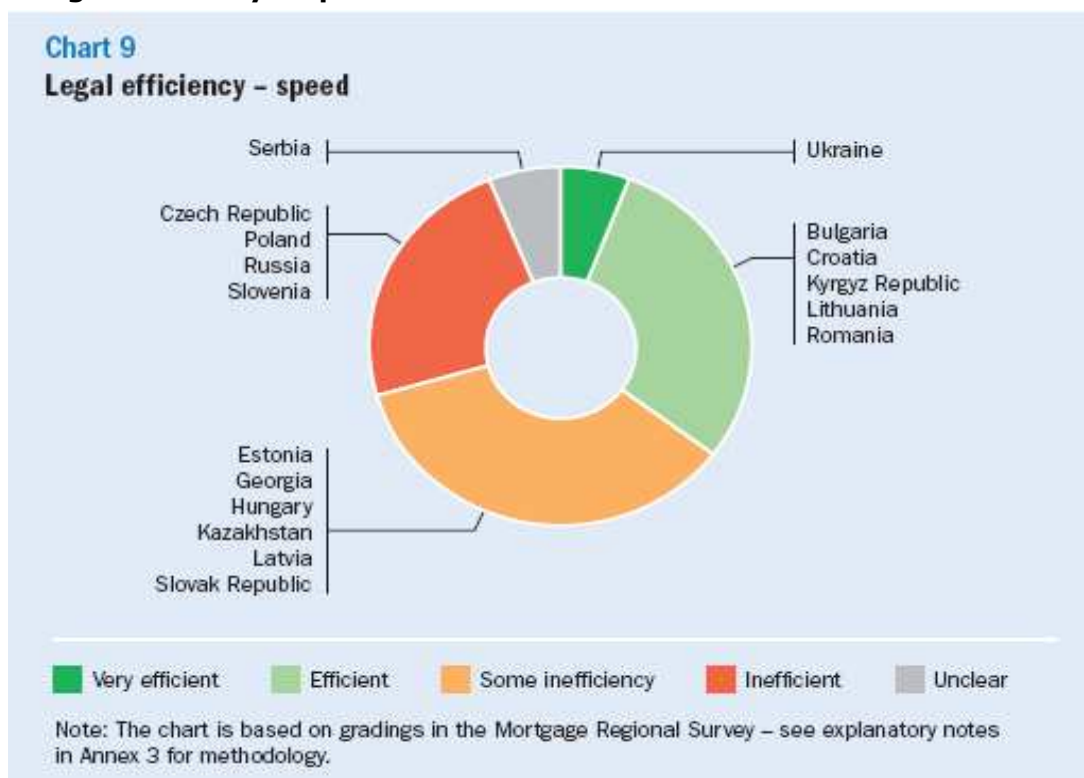
The basis for issuing the bank enforcement title are the bank books, which have the power of official documents attributed by the legislator.

It is also necessary to have appointed to it the enforcement clause by the court within 3 days (as in the case of titles originating from non-bank creditors) and

filing by the bank debtor the statement on submission to the enforcement procedure in the written form.

The authors indicate also the **negative example of France** as where registration is furthest from being simple. The problems of other countries: limit of mortgages validity – 15 or 30 years – seem to be associated with a much more important risk for collateral existence than the fact of existence of two types of mortgages to select from. (The Report authors see the proportions of adequate risks differently)

c. **Chart 9 Legal efficiency – speed:**



*Mortgages in transition economies. EBRD, p. 36*

The EBRD Report reproaches Poland for inefficiency of court bailiffs – highly inefficient – similarly as for Russia and Georgia. **Poland is in the group of three most unprofessional markets among 17 CEE countries.**

**CORRECTIONS TO CHART 9:**

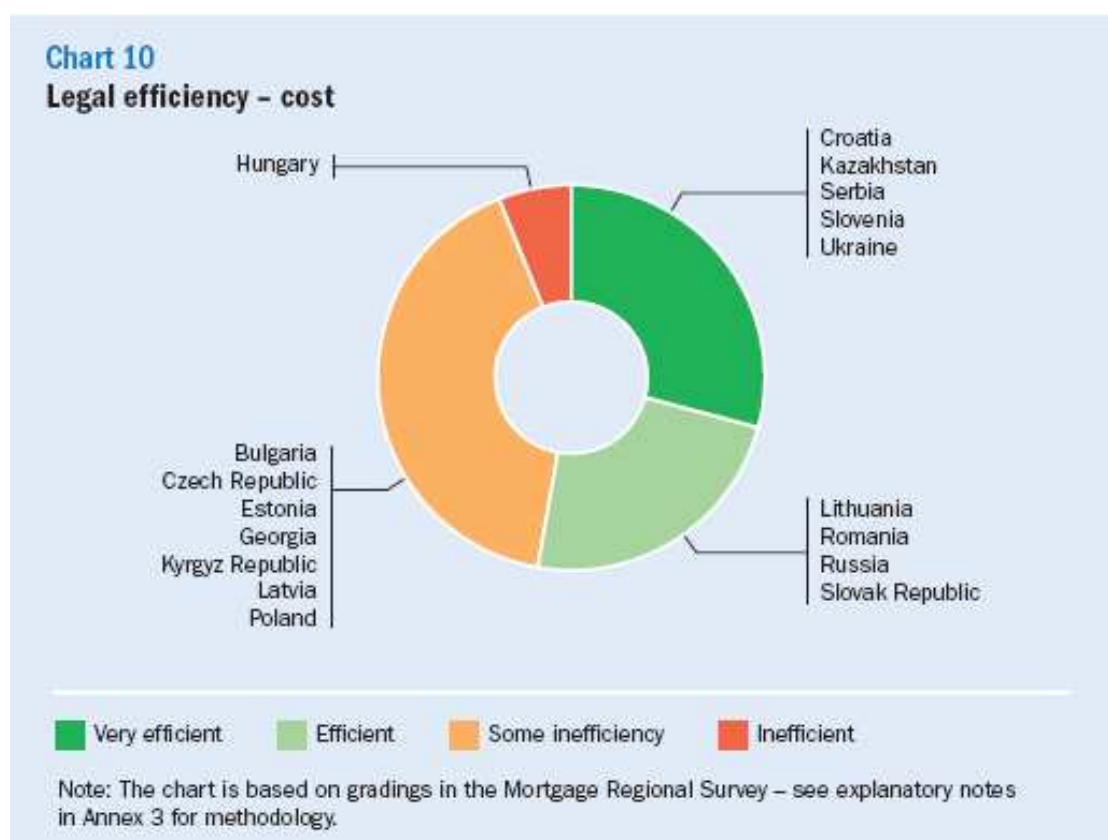
Poland was assessed here as an inefficient system, which cannot be agreed with. The grades are based on two questions: "Is creation of a mortgage rapid?" and "Is enforcement of mortgage rapid?". However, due to the lack of uniform methodology, the data are not comparable. As it has already been mentioned, mortgage registration for making it public in Poland takes up to 7 days (if the institutions of note – *in Polish: wzmianka* - in the register is taken into account), which should classify **Poland in the efficient category** (cf. item V.c of this document).

**As to the reproach of inefficiency of bailiffs** (registration of information on commencement of the enforcement process) – **this issue has already been noticed and is already regulated.** Concomitantly with sending the summons to

the debtor, the bailiff sends to the court, which is responsible for keeping the land and mortgage register a request for entering into the land and mortgage register the entry on commencement of the enforcement process or for filing the request with the set of documents (Article 924 of the Code of Civil Procedure).

It should also be noted that if the report assesses the practice, then in accordance with the Polish practice, the enforcement is replaced by contractual sale – the effect is entirely different than in the case of the court procedure, with the potential problem with eviction. Acting in consultation with the debtor gives as a result 100% recoverability of the debt.

d. **Chart 10 Legal efficiency - costs:**



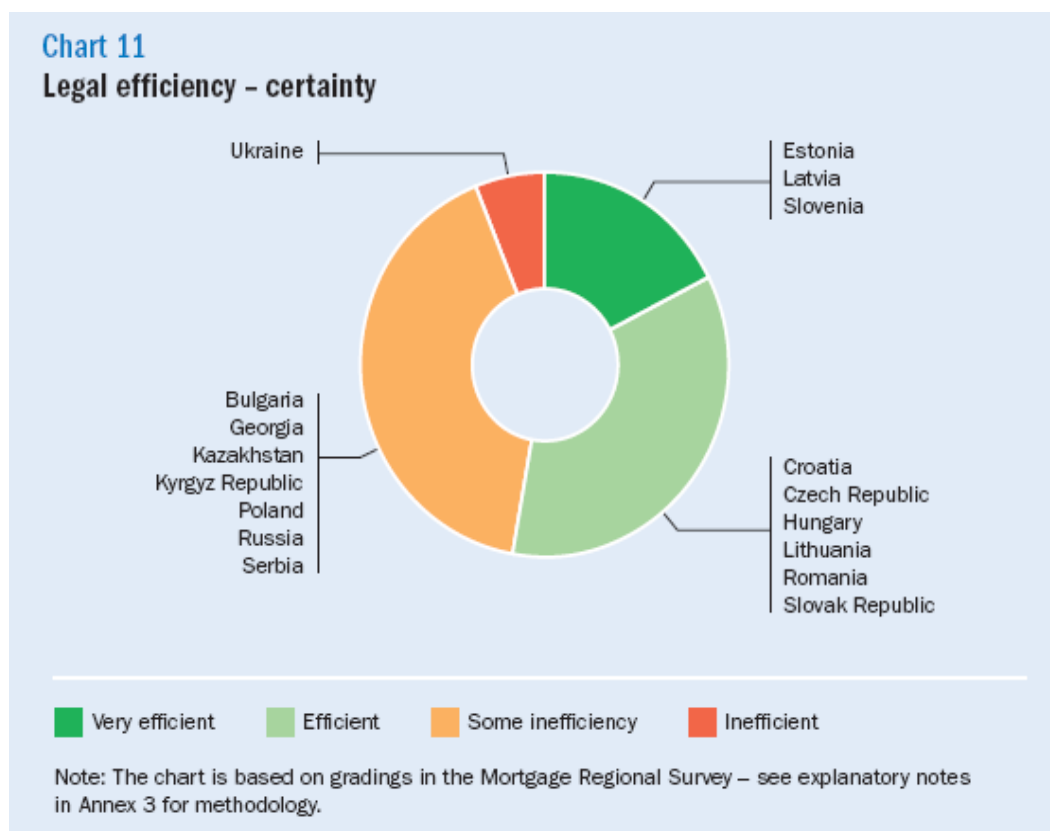
*Mortgages in transition economies. EBRD p. 37*

**COMMENT to Chart 10:**

It is very surprising that Poland was classified in the some inefficiency category, because the costs of mortgage creation in Poland are among the lowest in Europe. For example, these costs for a loan worth EUR 50,000 are ca. EUR 100, and thus 0.2% of the loan value, and in other countries they range between EUR 350 to EUR 3,000 (6% of the loan value!).<sup>9</sup>

<sup>9</sup> Data after: European Mortgage Federation, *Study on the Efficiency of the Mortgage Collateral in the EU*, 2007 p. 11.

e. **Chart 11 Legal efficiency – certainty:**



*Mortgages in transition economies. EBRD p. 38*

Certainty is a category assessed by EBRD on the basis of the following questions:

- Can existing title to property be established with sufficient certainty?
- Is the mortgage creditor protected from subsequent claims which may adversely affect the mortgagor's title to the property?
- Can a third party determine whether property is mortgaged?
- Is mortgage creditor protected against mortgagor obstruction?
- Does commencement of enforcement have to be publicised?
- Is purchaser in enforcement procedure protected?

**CORRECTIONS TO CHART 11**

In the opinion of Foundation experts, in the case of Poland the answers to all these questions – in the aspect of both the legal system and the practice – are positive.

**Therefore, the EBRD's assessment of "some inefficiency" (third level on the above 4-level negativity scale) is very surprising.**

**COMMENT:**

Such effect of the survey as a resultant of the methodology, some scope of information, report philosophy, content of the recommendations – whatever is the background for the survey – **states untrue information, and – contrary to the authors' intention – results in disinformation of the investors, analysts or rating agencies.**

Although there can be some reproaches in the case of the Polish system as to the time of full registration in the land and mortgage register (above the required



EBRD standard), this is indeed the effect (as emphasised by the authors themselves) of procedures checking the reliability of legal titles before registration, keeping the register by courts and on responsibility of the State judiciary, public faith warranty of the registers, resulting presumptions, etc., cf. item VI.d. This one issue – certainty and reliability of the registration – is placed by them beyond all doubt.

Certainty of existence of the strong right of the mortgage creditor is also comprehensively guaranteed in the enforcement and bankruptcy proceedings; of key importance here is to define the rank of the mortgage creditor – he is preceded only by the claims which must be present and do not differ from the positive EU standard – i.e. alimony claims, claims for work, limited to the procedure costs. They are identifiable. What is important and has been achieved owing to numerous reforms of the Polish mortgage is that no so-called “secret” rights exist, which encumber the property without any entries – in practice tax liabilities (income tax) were here of the greatest importance, but tax privileges are already abolished in Poland.

Both the information on existence of mortgages encumbering real property as well as on commencing the proceedings concerning the real property are fully available for the public, the mortgage creditors obtain the information on application of enforcing proceedings *ex officio* – these procedures are precisely regulated and performed by court authorities; also supporting activities by bailiffs are covered by court supervision.

**Certainty and incontrovertibility of the mortgage is in the Polish system certainly its strongest value – this is also the justification for prolonging the registration time, in connection with the formalities which precede it.**

Especially at this point, the report authors assume the gradation of weight of the criteria for determining registration certainty – disregarding the market reality and these factors which are determinant indeed for the risk of mortgage financing.

#### Example:

A significant factors determinant for positive assessment of certainty by EBRD is analysing what part of real estate market is registered in the land and mortgage registers or cadastre. **It is also stated that it is a problem in Poland and – what is ultimately demonstrated by the chart – it contributes to a negative grading of mortgage certainty.**

However, it should be noted that the level of covering the country surface area by the register **has nothing to do with certainty of the created mortgage** – a real property not included in the cadastre, the right and formal identification for which are not established, simply cannot be the object of financing with the mortgage loan. The issue analysed may at the most affect the potential of mortgage market development in the given country – but not mortgage certainty.

#### Methodological inconsistencies

Leaving aside the fallaciousness of the above measure of mortgage certainty used by EBRD, the information referred to in the case of Poland is untrue. Poland is characterised by a relatively very high level of disclosure of real properties in land survey registers. This may be considered 100% with respect to the pool of real properties which are the subject of interest of mortgage financing, in particular home and commercial financing, to which the report applies.

Similarly with the issue of restitution claims – they exist as a problem but **in the context of assessment of mortgage certainty they exist only if they would interfere with the existence of the established security – this issue is not examined by the report.** Therefore, restitution claims are a measure of mortgage certainty assessment only on the basis of the general statement on whether they exist or not.

Is all the more inadequate that first, even change of the owner as a result of restitution does not interfere with the established mortgage – because it is a substantive right, it follows the object and is effective regardless of the transfer of real property ownership (Article 65 (1) of the Act of the Act on Land and Mortgage Registers and Mortgage). Second, only exceptionally physical recovery of real property is possible – it is mainly the issue of claims for damages covered by the State Treasury.

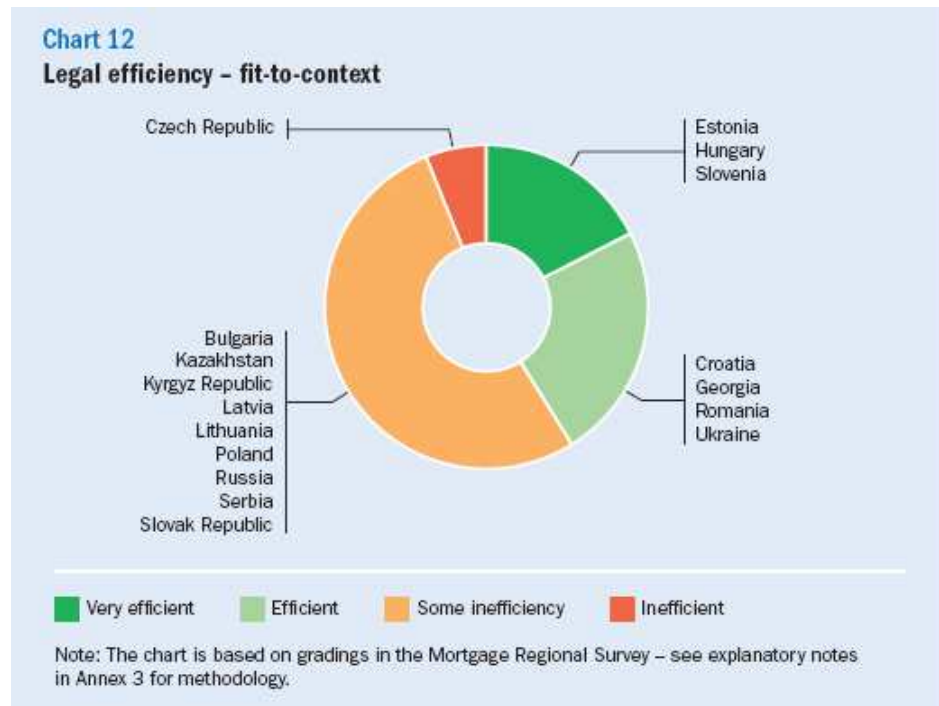
**To sum up, it does not seem to be reasonable to consider the issue of restitution in the common understanding of this problem a significant measure of mortgage certainty.**

On the other hand, subjective grading and diversified perception of the risk calibre in the case of countries which are considered as those with the highest certainty of creating and realisation of mortgages, indicate very high calibre disadvantages of the system. An example is making enforcement procedure and eviction conduct dependent on additional administrative decisions which allow them or not, depending on who resides in the flat (wide scope of protection in view of age, family situation).

Making mortgage realisation dependent on an additional administrative decision made at the moment of initiating the enforcement procedure seems to be an extremely important factor putting into question the certainty of mortgage in enforcement – nevertheless, the result of the survey shows that it was graded as minor using the EBRD methodology.

However, the example of this risk and unpredictability of the content of this administrative decision constitute a significant systemic risk of mortgage realisation.

f. **Chart 12 - fit-to-context:**



*Mortgages in transition economies. EBRD p.39*

**CORRECTIONS TO CHART 12**

**Here, in the case of Poland the result that the system has some inefficiency is difficult to be commented on at all, since no clear information is given on what was the basis for this grading.**

**COMMENT:**

The answers are positive to all questions assumed as measures by the authors.

**General remark to the methodology:** at places the EBRD authors remind the reader that the conclusions of the report result from the respondents' assessment. An example is the results of the fit-to-context chart.

However, the respondents do not identify themselves with the results in the charts, because when granting the answer they did not know what was the context in which it was used or how the comparison was made.

The drawback of this assumption is also the incomparability of the respondents. The more the experience of the respondent applies to the "sophisticated" and complicated part of the real estate market, e.g. with respect to syndicated financing, high complexity of transactions, the less satisfactory will be the answers to questions, for example, on whether mortgage creation is simple or on whether the enforcement process is rapid.

The same question asked for a typical and simple transaction, e.g. in a typical housing market, will obtain a different, certainly more optimistic answer.

Unfortunately, this is not differentiated by the authors of this report, and it seems to be of essential importance for the ambitious task of grading the quality and certainty of system.

It is similar with the non-uniform selection of the category of respondents. In one countries, the question on assessment of the procedures is asked to the ministries which establish and apply such procedures, and thus they know them perfectly well, and in other countries this question is asked to market practitioners who are naturally more critical in their assessment of the procedures.

See also remarks – item I.7 and the fact that for some markets only 3 respondents were surveyed (Poland) and for others it was for example 15 persons (list of respondents p. 2 of the EBRD Report).

## Annex 2: Mortgage Regional Survey –

The survey is best understood if read in conjunction with the EBRD Core Principles for a Mortgage Law (see Annex 1), which specify the basic criteria for modern mortgage law, and the explanatory notes (see Annex 3), which describe the methodological approach to the survey.

	Bulgaria	Croatia	Czech Republic	Estonia	Georgia	Hungary
<b>1 Creation of the mortgage</b>						
1.1 Can existing title to property be established with sufficient certainty?	xx +	✓✓ +	✓✓✓	✓✓✓	✓✓✓	✓✓✓
1.2 Is the manner of creation of mortgage clearly established?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
1.3 Is creation of mortgage simple?	xx +	xx +	✓✓✓ +	✓✓✓	✓✓✓	✓✓ +
1.4 Is creation of mortgage rapid?	✓✓	✓✓	xx +	xx +	✓✓	xx +
1.5 Is creation of mortgage inexpensive?	✓✓	✓✓✓	✓✓✓	✓✓	✓✓	xx +
<b>2 Commercial effectiveness</b>						
2.1 Can a mortgage be granted by any person?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
2.2 Can any person take a mortgage?	✓✓✓	✓✓✓ +	✓✓✓	✓✓✓	✓✓✓	✓✓✓
2.3 Can the mortgage secure any type of debt?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
2.4 Can the secured debt be in any form?	xx +	✓✓ +	xx +	✓✓✓	✓✓ +	✓✓✓
2.5 Can the mortgage cover all types of immovable asset?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
2.6 Does the mortgaged property include subsequent constructions and additions?	✓✓ +	✓✓✓	xx +	✓✓✓	✓✓✓	✓✓✓
2.7 Are subsequent mortgages permitted over same property?	✓✓✓	✓✓✓ +	✓✓✓ +	✓✓✓ +	✓✓✓	✓✓✓
<b>3 Effect of the security right on third parties</b>						
3.1 Is the mortgage creditor protected from subsequent claims which may adversely affect the mortgagor's title to the property?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
3.2 Does mortgage give priority in mortgaged property?	✓✓✓	✓✓ +	✓✓✓	✓✓✓	✓✓✓	✓✓ +
3.3 Does the mortgage creditor have priority in bankruptcy?	✓✓✓	✓✓ +	✓✓✓ +	✓✓✓	✓✓ +	✓✓✓
3.4 Can a third party determine whether property is mortgaged?	✓✓ +	✓✓✓	✓✓ +	✓✓✓	✓✓✓	✓✓✓
<b>4 Enforcement of the mortgage</b>						
4.1 Is the manner of enforcement of mortgage clearly established?	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
4.2 Is enforcement of mortgage rapid?	✓✓	✓✓	xx	✓✓✓	xxx	✓✓✓
4.3 Is enforcement of mortgage inexpensive?	xx	✓✓✓	xx	xx	xxx	xx
4.4 Is realisation likely to be at market value?	xx	xx	✓✓	✓✓	xx	xx
4.5 Is enforcement procedure simple?	✓✓✓	✓✓ +	✓✓✓	✓✓✓	xx +	✓✓ +
4.6 Can the mortgage creditor decide on the way the sale will be conducted?	xxx	xxx	✓✓ +	xxx	xxx	✓✓✓
4.7 Can the mortgage creditor exercise control over the realisation process?	xx +	xxx	✓✓ +	xxx	xxx	✓✓✓
4.8 Is the mortgage creditor protected against mortgagor obstruction?	✓✓ +	✓✓ +	✓✓ +	✓✓✓	xxx +	✓✓ +
4.9 Does commencement of enforcement have to be publicised?	xxx	✓✓✓	xx +	xxx	xxx	xx +
4.10 Is purchaser in enforcement procedure protected?	✓✓✓	✓✓✓	✓✓ +	✓✓✓	✓✓✓	✓✓ +

# composite table

✓✓✓ Yes      ✓✓ Yes, but with some reservations  
**xx** Indicates that response is negative, but there are some mitigating factors in law or practice  
**xxx** Categorical no      ? Uncertain      † Indicates there is an accompanying note. Please see pages 60-62.

Kazakhstan	Kyrgyz Republic	Latvia	Lithuania	Poland	Romania	Russia	Serbia	Slovak Republic	Slovenia	Ukraine
✓✓ †	✓✓ †	✓✓✓	✓✓✓	✓✓ †	✓✓ †	✓✓ †	✓✓ †	✓✓✓	✓✓✓	✓✓ †
✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
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<b>xx</b> †	✓✓	<b>xx</b>	✓✓	<b>xxx</b> †	✓✓ †	<b>xxx</b>	<b>xx</b> †	<b>xx</b> †	<b>xx</b> †	✓✓✓
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✓✓✓	<b>xx</b>	<b>xx</b>	✓✓	<b>xxx</b>	✓✓	✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
✓✓✓	✓✓ †	✓✓	✓✓✓	<b>xx</b>	<b>xx</b>	<b>xx</b>	? †	✓✓✓	✓✓	✓✓✓ †
✓✓ †	✓✓ †	✓✓✓	✓✓✓	<b>xx</b> †	✓✓ †	<b>xx</b> †	✓✓ †	✓✓✓	✓✓✓	✓✓✓
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✓✓ †	✓✓ †	<b>xxx</b>	<b>xxx</b>	<b>xxx</b>	✓✓ †	<b>xxx</b>	✓✓✓	✓✓✓	<b>xxx</b>	✓✓✓
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<b>xx</b> †	<b>xx</b> †	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓	<b>xx</b> †

Source: *Mortgages in transition economies*. EBRD p.58

## VIII. Annex 2: Mortgage Regional Survey (p. 58 of the EBRD Report) - corrections

### General remarks:

This composite table is the most important message of the EBRD Report as to the assessment of mortgage quality in individual countries. The table is poster-like and structured similarly to a rating system, and therefore is of extreme importance for business effects and potential allocation of international capitals (cf. remarks in item II. of this document). Having analysed the basis for the assessment of the Polish market it should be found that the *Mortgage Regional Survey* table has the following drawbacks:

1. Responses to the questions posed are made through detailed, marginal comments, sometimes to the practice and sometimes to legal regulations, without referring to the basic rules of the legal system or practice.
2. No systematic study of the specific issue was performed on the basis of the same criteria, taking into account the adequate transactions in the individual markets.
3. The answers have the nature of an impression, sentiment, and thus are only subjective – as it is even emphasised by the report authors themselves.
4. Taking into account the diversity of respondent categories (in Poland 3 respondents, in other countries up to 15 respondents) and subjectivism, the survey results, which are at the same time the system measure, seem to be absolutely inadequate.

The following conclusions contributed to the assessment of the system in Poland (question/answer).

### 1.1 Can existing title to property be established with sufficient certainty?

#### EBRD answer:

“There is still a significant amount of land for which checking title may be difficult.”

Report EBRD, p. 61

#### Foundation's correction:

Establishing real property ownership is relatively problem-free in Poland, as it is confirmed by the practice. It is just contrary to the report author's claim – the legal system ensures the possibility of establishing the ownership right to real property, especially if we take into account the market subject to economic trade. In the Polish system, the fact that for some real properties land and mortgage registers are not established, which is negatively commented in the report, does not preclude establishing the fact of real property ownership, because the basis of such establishment is the document confirming ownership acquisition (notarial deed, court decision on coming into inheritance). Entry into the land and mortgage register is not necessary for real property ownership transfer.

Commercial certainty is additionally ensured through the public faith warranty of the land and mortgage registers as to the disclosed owner (if an excerpt of the land and mortgage register exists, this reduces the need for using source ownership transfer titles).

### 1.3. Is creation of mortgage simple?

EBRD answer:

"Registration procedures are formalistic (although they have been simplified for banks' mortgages) and practice is not consistent. It is often necessary to create more than one mortgage because of technical distinctions between different debts."

Report EBRD, p. 61

Foundation's correction:

Mortgage creation in Poland **is simple**, especially for transactions in professional trade, and also typical market transactions, particularly in the housing market. The existence of two types of mortgages – which was viewed negatively by the report authors – is a positive fact, as it increases the flexibility of adjusting the type of security used to the properties of the given transaction<sup>10</sup>.

### 1.4. Is creation of mortgage rapid?

EBRD answer:

"Banks commonly disburse loans before registration is completed, based on confirmed registration application and/or additional collateral."

Report EBRD, p. 61

Foundation's correction:

This positive solution applied in practice was used by EBRD as a negative measure in system grading, with which we cannot agree. Moreover, as it has already been mentioned in item VI.d) of this document – the answer to the question about the speed of creating the mortgage in Poland is definitely positive when we take into account the institution of a note in the register – in Polish: *wzmianka* (registration – several days, and in practice - on the spot).

### 2.4 Can the secured debt be in any form?

EBRD answer:

"A generally defined debt or a fluctuating pool cannot be secured. A future debt can only be secured if defined specifically. There is a complex distinction between "capped" and fixed amount" mortgages."

Report EBRD, p. 61

Foundation's correction:

**The answer should be YES** – on condition that the debt is of pecuniary nature and the question assumes the existence of the debt. In Poland the fact of identifying the legal relationship is sufficient for securing the resultant debts.

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<sup>10</sup> The ultimate postulate of the Foundation is to introduce into the Polish law a fully flexible mortgage or land debt (in Polish: *dlug gruntowy*). Nevertheless, this does not change the fact that also on the basis of the current regulations the mortgage operates as good-quality security.



Granting answers in the context of the very sophisticated issue of debt pool is not a comparable assessment measure, because this criterion was not applied with respect to other countries. As a matter of fact, there is no such experience in the market practice in Poland.

## **2.7 Are subsequent mortgages permitted over same property?**

EBRD answer:

"A clause prohibiting further mortgages is void."

Report EBRD, p. 61

Foundation's correction:

The answer is not disparate with the EBRD's conclusion and is also YES.

## **3.1 Is the mortgage creditor protected from subsequent claims which may adversely affect the mortgagor's title to the property?**

EBRD answer:

"There is still some limited risk of a restitution claim."

Foundation's correction:

The basic answer for Poland should be YES. The mortgage creditor is secured. This arises from the general rule of effectiveness of security interests, including the mortgage *erga omnes*. Furthermore, numerous regulations exist which protect mortgage creditors in accordance with the order of their entries. The issue of restitution claims is a marginal issue in the common practice and is not of significant importance for the creditor, because in this case he has some protective measures at his disposal.

Similarly as in previous cases, the authors answer the question of the EBRD Report authors through determining the derogation from the rule and not the rule itself in the first place.

## **3.2 Does mortgage give priority in mortgaged property?**

EBRD answer:

"Some claims (alimony, last three months' employee wages and invalidity pensions) take priority over the mortgage creditors' claim."

Foundation's correction:

Yes, in Poland mortgage gives priority at the level of the European standards. After the reform, mortgage is preceded only by identifiable categories – they are not responsible for ineffectiveness of the security, it is a package generally acknowledged in most of the European countries. Therefore, the answer cited should not be considered a negative message. Just the opposite – in view of the limited nature of these categories, it should place Poland at a high level of certainty of the position of the mortgage creditor.

Cf. information on Polish system in item VII. A) of this document.

### 3.4 Can a third party determine whether property is mortgaged?

EBRD answer:

"Obtaining excerpt may be limited to interested persons."

Report EBRD, p. 61

Foundation's correction:

The answer should be YES. Everybody, even a non-interested party could easily find out whether the real property has mortgage encumbrance. (The excerpt issue was not subject to the question).

### 4.5 Is enforcement procedure simple?

EBRD answer:

"The procedures are formalistic and the operation of the bailiff system is reported to be inefficient."

Foundation's correction:

The answer granted is too general – formalism exists and is required everywhere where we want to ensure the effectiveness of the security against third parties. Furthermore it is not taken into account that the bailiff's activities were systemically enhanced by the recent reform (2007) – cf. information on Polish system, item VII.c).

### 4.9 Does commencement of enforcement have to be publicised?

EBRD answer:

"The bailiff is required to register commencement of enforcement in the land register, but in practice there may be delay before registration is completed."

Report EBRD, p. 61

Foundation's correction:

The bailiff's duty arises from the Act – in accordance with Article 924 of the Code of Civil Procedure **concomitantly** with sending to the debtor the summons by the bailiff to the court responsible for keeping the land and mortgage register the request for making in the land and mortgage register the entry on commencement of enforcement procedure or on enclosing the request into the document set. Therefore, the principle presented in the Polish law creates a systemic stimulus increasing the efficiency of action of bailiffs.

Warsaw, 1 August 2008.