



Section 1

Background

- Introduction to Bank of Ireland
- Project Objectives
- Project Techniques
- Advisers Profiles

Section 2

Key Findings

- Overview of Minimum Standards and Best Practices
- Mortgage Lending: Minimum Standards and Best Practices

Section 3

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- Key Findings: Romania
- Key Findings: Bulgaria
- Key Findings: Croatia
- Summary of the markets

Section 4

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Section 1

Background

Presentation to the SEE Mortgage Finance Network

Split, Croatia

25th May 2004

Advisory Services provided by:

Bank of Ireland 
Business Banking



European Bank
for Reconstruction and Development

Bank of Ireland

Introduction and Overview

Background

- Established in 1783 – 220 years in Banking
- Broadly Based financial Institution, providing services to a wide range of clients
- 18,000 staff worldwide
- Profit on ordinary activities (before exceptional items) – Half Year (Sept 03) - €642m. Full Year (March 03) - €1,177m
- Return on Equity – In excess of 20% for the 10th successive year
- Strong Asset base – Total assets - €99bn



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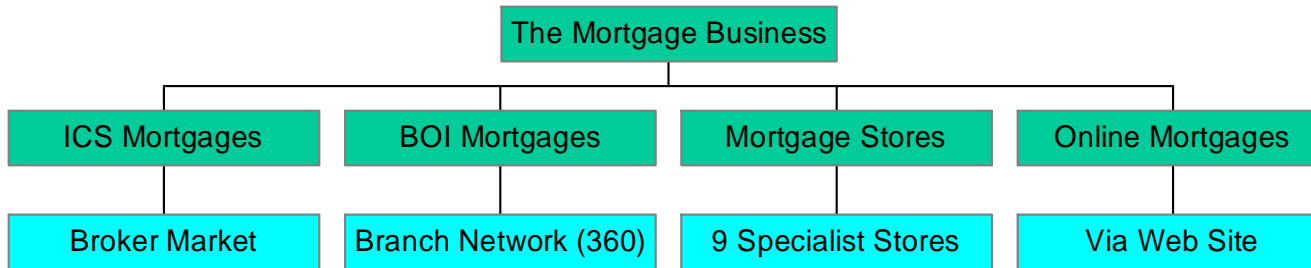
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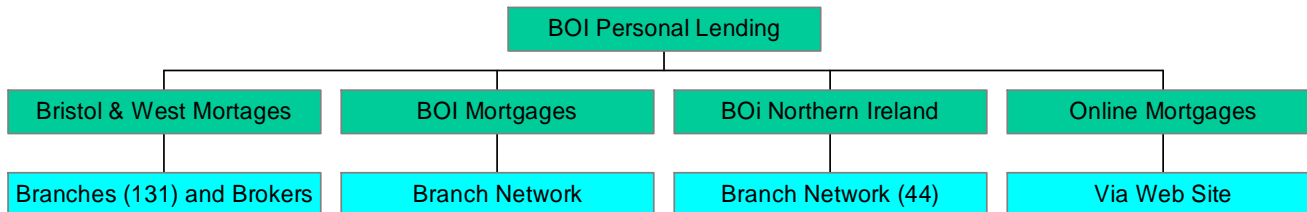


Residential Mortgage Business

The Mortgage Business Ireland



The Mortgage Business UK





Residential Mortgage Business

- Represents 49.86% of the total loan book (€32bn/64bn)
- Mortgage Business in Ireland – €10.7bn
- Mortgage Business in UK - €21bn
- 26% Mortgage Market share in Ireland
- Key delivery channels – Branches, ICS Mortgages, Mortgage Stores, Web Site
- Mortgage operations both in UK and Ireland
- First Securitisation (MBS) of the Loan Book undertaken in 1980's (BIM – UK)
- First Securitisation (MBS) of the Loan Book in Ireland undertaken in 2000
- Series of Mortgage Bond (MCB) issues planned for next 5 years.





Project Objectives

Overall EBRD Objectives

To facilitate the development of secondary mortgage markets in EBRD's countries of operation through the creating pools of primary mortgage sub loans that are capable of secondary market re-financing

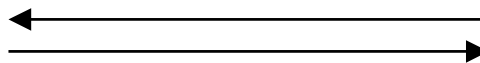
Assignment Objectives

- To identify 'Minimum Standards' and 'Best Practices' pertaining to the process by which Mortgage loans are originated and managed by lenders that would ensure that standards meet the criteria to allow fulfilment of the overall objective (above)
- To document the above in a Manual
- To review a sample number of countries to gain an **overview** of the mortgage market in these countries
- To examine the application of the Minimum Standards and Best Practices in Mortgage lenders in the sample countries
- To present a completed Minimum Standards Manual and to outline the key gaps and deviations from the Minimum standards in the sample countries



European Bank
for Reconstruction and Development

Team/Project Structure



Steering Meetings/Site Visit reports



European Bank
for Reconstruction and Development

Project
Director

Senior
Adviser

Project
Manager

Project
Researcher



Croatia
Croatia Banking
Association



Romania
Romanian Banking
Institute



Bulgaria
International Banking
Institute

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25th May 2004

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Rory Spain

Rory Spain is a career banker with more than 30 experience in commercial banking with Bank of Ireland. For the past 15 years, Rory has almost exclusively been involved on the central development of the Bank of Ireland Group Mortgage business. He has been responsible for the design, development and implementation of a mortgage system within Bank of Ireland; the review of existing legislation and procedures in Northern Ireland prior to setting up the Mortgage business; managed the research and development of a securitisation programme and delivered business and technical mortgage training to a wide variety of staff. He has also been responsible for the design and delivery of a specialist Mortgage Practice Training programme on behalf of Bank of Ireland and the Institute of Bankers in Ireland. This programme has been delivered to over 2000 staff in the Bank of Ireland Group. In addition, Rory has undertaken numerous assignments relating to the Mortgage Business in markets overseas.



Greg Allen

Greg Allen is a banking adviser and trainer specialising in the areas of Mortgages and Securitisation. As Head of Operations within the Bank of Ireland's ICS Building Society, Mr Allen was responsible for the development of new mortgage based products within the Group., reflecting the changing needs of the Irish Market. In addition, Mr Allen was responsible for a team which managed the first asset backed Securitisation of the Bank of Ireland residential mortgages. This included substantial interaction with the Rating Agencies. More recently, Mr Allen has been involved in the provision of training in Ireland and Spain in the area of Mortgage Practice and Financial Management for Banks.

Section 2

Key Findings

Presentation to the SEE Mortgage Finance Network

Split, Croatia

25th May 2004

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Overview

The Mortgage
Process

Mortgage
Documentation

Business
Structure

Property
Valuation

Property
Ownership

Insurance

Credit & Risk
Management

Lenders
Criteria

Security
Requirements

MIS/IT &
Account
Management



The Mortgage Process

Minimum Standards

- *Documented Process/Flow Charts*
- *Responsibilities/Authorities/Defined Organisational Structure*
- *Continuous Review/Training*

Reasons for Minimum Standards/Best Practices

- *Prudent Business Practice*
- *Investors/Rating Agencies - Evidence*



Mortgage Documentation

Minimum Standards

- *Legal Input*
- *Application Form*
- *Verification Docs*
- *Offer Letter/Loan Agreement*
- *EMF Voluntary Code*
- *Pre/Post sale information*
- *Supporting Documentation*

Best Practice

- *Consumer Protection*

Reasons for Minimum Standards/Best Practices

- *Evidence*
- *Records*



Business Structure

Minimum Standards

- *Structure supported by necessary checks*

Best Practice

- *Centralised*
- *Decentralised*

Reasons for Minimum Standards/Best Practices

- *Evidence for Rating Agencies and Investors*



Property Valuation

Minimum Standards

- *Professional/Recognised Professional Body/PII*
- *Comprehensive Report*
 - Property Details
 - Market Value
 - Purchase Price
 - Reinstatement Value
 - Repairs
 - Environmental Issues (EBRD)

Reasons for Minimum Standards/Best Practices

- *Evidence of Professional Independent Valuations*
- *Records*



Property Ownership

Minimum Standards

- *Freehold Title (ownership without limit in time)*

Or

- *Leasehold Title*

Or

- *In Rem Right (civil legal system)*

Reasons for Minimum Standards/Best Practices

- *Evidence/legal title/security*



Insurance

Minimum Standards

- *Life Assurance*
 - *Cover amount/term*
 - *Assigned*
- *Buildings Insurance*
 - *Reinstatement Value/Indexing Linked*
 - *Joint Names/Assigned*

Best Practice

- *Contents Insurance*
- *MIG*
- *Home Builders Guarantee*
- *Property Title Insurance*
- *Mortgage Payment Protection*

Reasons for Minimum Standards/Best Practices

- *Rating Agencies/Investors require minimum standards*
- *Prudent Business Practice*
- *Benchmark Pools*



Credit & Risk Management

Minimum Standards

- *Documented Credit Policy*
- *'Ability to Repay'*
- *Loan Assessment (7 steps)*
- *Arrears Management*
- *Managing Risks*
- *Lending Skills/Training*
- *Tiered Discretions*
- *Succession Planning*

Best Practice

- *Turnaround Time*

Reasons for Minimum Standards/Best Practices

- *Ensures proper and ongoing management of loan book*
- *Rating Agencies/Investors expectations*



Lenders Criteria

Minimum Standards

- *Loan Purpose*
- *Product Type*
- *Property Location*
- *Borrower Profile/Age*
- *Loan Term*
- *Min/Max Amount*
- *Affordability Test (NDI, DSR, PTI)*
- *LTV Ratio*
- *Valuation*
- *Tenure*
- *Security*
- *Verification*

Best Practice

- *Geographic/Employer Spread*
- *Max 80% LTV unless supported by MIG*

Reasons for Minimum Standards/Best Practices

- *Clearly Defined Standards*
- *Prudent Business Management*
- *Benchmark Pools*



Security Requirements

Minimum Standards

- *First Legal Charge*
- *Life Assurance*
- *Buildings Insurance*

Other

- *MIG*
- *Liens/Guarantees*

Reasons for Minimum Standards/Best Practices

- *Prudent Business Practice*
- *Ratings Agencies will undertake review of security in pool*



MIS/IT & Account Management

Minimum Standards

- *System Accounting capability for current/planned business*
- *Relevant Management Information reports available*
- *Relevant Monitoring and account management practices*

Reasons for Minimum Standards/Best Practices

- *Business has the necessary systems and information for effective operation*
- *Capability of capturing information required by Rating Agencies*

Section 3

Application of Minimum Standards

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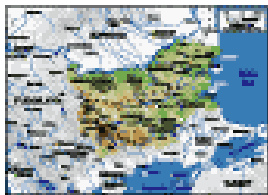


Romania

- Mortgage Process in place in sample banks*. Lack of clear evidence of continuous Development Programmes for Mortgage Lending
- EBRD Documentation used significantly. Documentation now needs to be reviewed
- Operational Structures in all banks sampled appear to be supported by the appropriate controls.
- Comprehensive Property Appraisal Reports undertaken by professionals. Samples viewed.
- Land Registry system is satisfactory but completed locally – no central Registry. (freehold title)
- Life Assurance not mandatory by law – some banks require/others do not. Buildings Assurance requirements range from Market Value to Mortgage Value (+10%)
- Credit Management Policies evident – further in-depth analysis required. Arrears level low. Foreclosure process untested
- Security Requirements partially fulfilled – Life and Buildings *policies* do not meet min. standards.
- Lending Criteria generally meet requirements of min standards. DSR was 50% - reduced to 35% (National Bank)
- Reporting not examined in depth. Account Management System appears effective, but further examination required

Current Capacity: **No current secondary Market. Capacity for Domestic Securitisation/Mortgage Bonds. Strong Review Team in Place. Draft New Legislation issued February 2004.**

* *See Appendix 2*

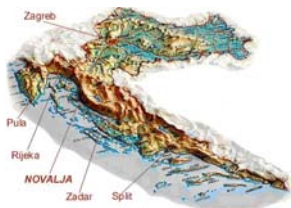


Bulgaria

- All lenders showed evidence of fully documented Mortgage process
- EBRD Documentation used significantly. Documentation now needs to be reviewed
- Operational Structures in all banks sampled* appear to be supported by the appropriate controls.
- Property Valuations undertaken by suitable professionals. Property reports require review.
- Effective Land Registry system in place (online, 24 hours turnaround, Freehold)
- Life Assurance not required by law, but is by most lenders. Buildings Insurance available but range from Market Value to Mortgage Value (+)
- Credit Management Policies evident. Arrears levels low on recent book. Differing experiences with foreclosure process
- Min Standards for Security Requirements covered, but Buildings insurance value falls short of minimum requirements
- Reporting not examined in depth. Account Management System appears effective, but further examination required
- Lending Criteria generally meets minimum standards. DSR 45%/50% range

Current Capacity: **Current Local secondary Market in place. New SPV law enacted**

** See Appendix 2*



Croatia

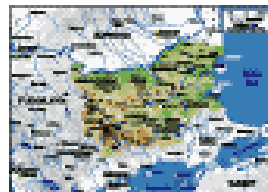
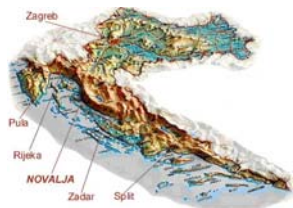
- Mortgage Process in place in sample banks*. Lack of clear evidence of continuous development programmes for Mortgage Lending
- EBRD Documentation in use. Review Required.
- Operational structures in sampled banks appear to be supported by appropriate controls
- Property Valuations undertaken by suitable professionals. Reports – further review
- Land Registry System ineffective. Concerns over accuracy and delays.
- Life Assurance not compulsory – where taken – Max 40%
- Buildings insurance compulsory – issue around amount of cover
- Credit Management Policies evident. Arrears level low. Lenders reluctant to foreclose. Reliance on other methods
- Min Standards in Security not always in place. Fiduciary security sometimes taken – Issues over life/Buildings insurance
- Reporting not examined in depth. Account management system appears effective – further examination required
- Lending Criteria generally meetings requirements. DSR 33%. Valuations written down.

Capacity: No capacity for secondary mortgage market at present.

* *See Appendix 2*



Summary of Three Markets



- Review undertaken in SAMPLE banks* only. Limited Exposure to in-depth documentation review etc.
- Documentation/Process/Credit Assessment appears adequate in all markets subject to some reviews
- Concerns over non compliance with Life and Buildings Insurance requirements
- Secondary Market active in Bulgaria. Progress in Romania. No progress in Croatia evident.

* See Appendix 2

Section 4

Application to Secondary Markets

Presentation to the SEE Mortgage Finance Network

Split, Croatia

25th May 2004

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Business Banking



Application and Overview of Securitisation

- Financing Asset Side of the Balance Sheet.
- Understanding Mortgage Backed Securities and Mortgage Bonds.
- International and Domestic Considerations.
- The Future of Secondary Market Activity.
- Future Requirements.



Financing the Asset Side of the Balance Sheet

- Banking profitability comes down to net interest margin and your cost structure.
- At a fundamental level, core deposits from small customers is the cheapest funding available to a financial institution.
- The problem of lending long and borrowing short creates a maturity mismatch particularly when residential mortgages are a substantial asset class.
- In many jurisdictions there is not great volatility on customer deposits;
- What tends to happen is that as customers become more sophisticated they may see opportunities for a higher return for the same or less risk and increase the volatility of deposits and lead to an increase in interest expense;
- Large scale banks as they grow do so because they are identifying profitable lending opportunities and find that they are short on core deposits and need to source more and more of their resources at a market rate.
- Essentially the ability to grow the asset side of the balance sheet becomes constrained because of funding and the financial institution can only attract funding by raising the price it is prepared to pay for others money.
- There is an aggregation and cost problem with this.



- Essentially large scale funding transactions are attractive and a financial institution could ...
 - Issue unsecured corporate bonds;
 - Covered mortgage bonds;
 - Structured covered mortgage bonds;
 - Securitised mortgage bonds.

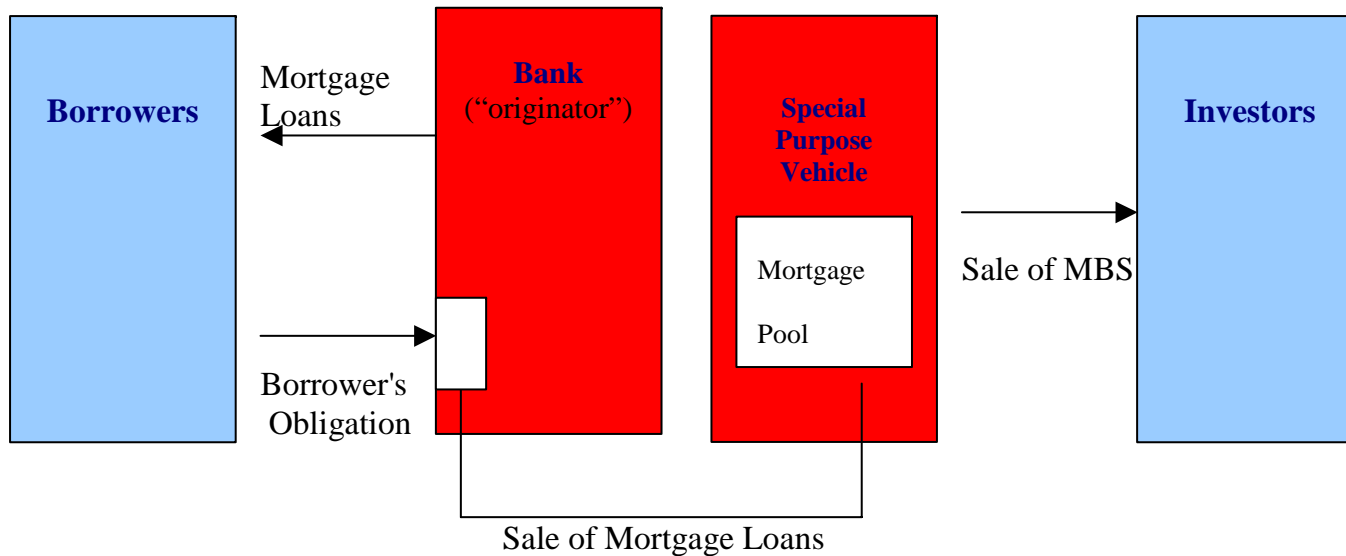
The first category will price depending on the rating of the originator which will determine its coupon;

The other three will price differently because they have different protection structures above that of the unsecured bond. There is a key element to residential mortgages and that is a low level of default with diversified risk and they are well regarded by investors. By bundling them together it is possible to raise funding at 'AAA' rates and thus provide a relatively lower cost of funding to a financial institution than they otherwise would get.



Understanding Mortgage Backed Securities and Mortgage Bonds

Mortgage Backed Securities Process¹



¹ source: European Mortgage Federation: "Mortgage Banks & Mortgage Bond in Europe" Figure 3



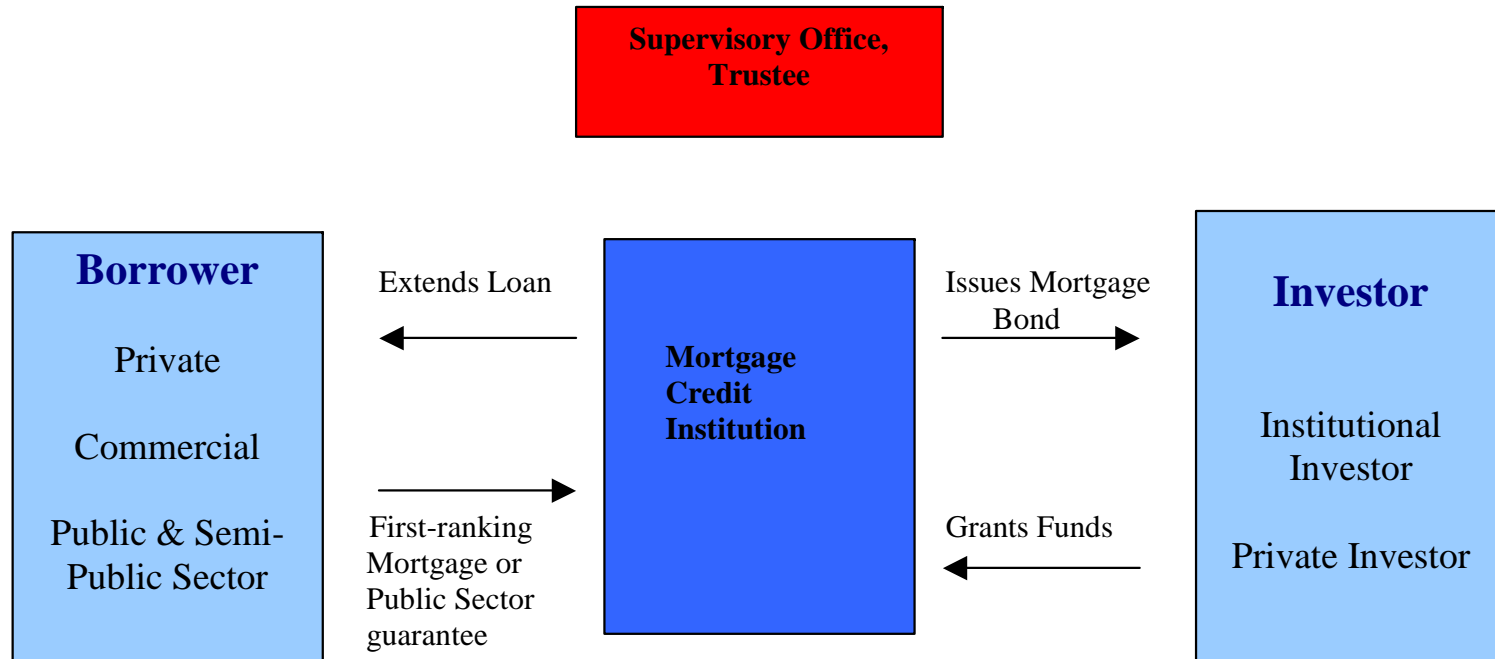
Understanding Mortgage Backed Securities and Mortgage Bonds

- **Mortgage Backed Securities:**
 - Pool assets are identified and often removed from balance sheet to a 'special purpose vehicle';
 - The assets are the source of cashflows providing interest and principal repayments;
 - Securities are backed by the asset pools of each specific asset or mortgage backed deal;
 - In the event of the assets of the pool being insufficient to cover their claims, holders of MBS have no recourse beyond the collateral in the pool.
 - The originator decides the assets and there may be additional assets included such as equity release for mortgages already in pool;
 - Asset quality is a function of the strengths of the specific structure created for the MBS
 - Credit risk; interest rate risk; prepayment risk; market risk are assumed by the investors;
 - Pricing reflects specific elements of the deal such as overall LTV etc.
 - The SPV is normally bankrupt remote from originator i.e. the SPV is not owned by the originator;
 - The bonds generally redeem in line with the amortisation of the underlying loans;



Understanding Mortgage Backed Securities and Mortgage Bonds

Mortgage Bonds Process¹



¹ Source: European Mortgage Federation: "Mortgage Banks & Mortgage Bond in Europe" Figure 1



Understanding Mortgage Backed Securities and Mortgage Bonds

- **Mortgage Bonds**
 - Cover assets remain on originator's balance sheet; they may be maintained in pools or placed in a special pool affiliate;
 - Originator is source of cashflows providing interest and principal repayments;
 - Covered bondholders have no direct or separate claim against any specific subset within the pools;
 - Covered bondholders have some recourse to non-eligible assets. Where there is a special affiliate there may be recourse to the parent;
 - Eligible assets are often defined by law and are substitutable. The asset mix of the pool varies;
 - Asset quality is a function of the originator's origination and underwriting standards as well as features of the covered bond framework;
 - Cashflow matching is not usually required by law;
 - Credit risk; interest rate risk; prepayment risk; market risk remain with the originator;
 - There is a strong element of 'over collateralisation';
 - The bond holder has a priority claim on the assets if the originator goes bankrupt;
 - The bonds generally redeem in bullet form.



International Investors

- Mortgages as an asset class either in Mortgage Bonds or Securitisation are such that international investors are attracted to them because of their low risk of default and that they pay more than Government Bonds;
- There is a lot of issuance and the investor base is widening;
- Unique or specific risks of a particular country will at best mean higher pricing or at worst investors simply won't buy the bonds;
- Selling into the international market means adopting some of the standards that the investors are expecting as standard in the market;
- This is not saying that investors cannot be convinced on certain idiosyncratic features.

Domestic Investors

- Essential that the Domestic market is tapped first;
- Likely to be better investor understanding of matters that international investors might walk away from;
- This can generate the ability to fine tune the market;
- If it was self sustaining why would international markets need to be used?



The Future of Secondary Market Activity

European Bank

for Reconstruction and Development

General:

- Securitisation likely to be seen more as a risk management tool and synthetic structures may evolve but will still be used for funding as well;
- Off balance sheet treatment will probably disappear replaced with disclosure on risk;
- More covered bond structures will seem like securitisations.



Future Requirements

- Continued specific Testing of Minimum Standards
- In-depth Gap Analysis of individual banks
- Ongoing support to banks to develop and implement Minimum Standards
- Ongoing and continuous review of Minimum Standards to reflect market conditions
- Examination of Legislative and Regulatory Frameworks
- Support to National Banks in supervisory role, where applicable
- Ongoing discussions with other IFIs and Donors regarding the application of minimum standards



Appendices

Presentation to the SEE Mortgage Finance Network

Split, Croatia

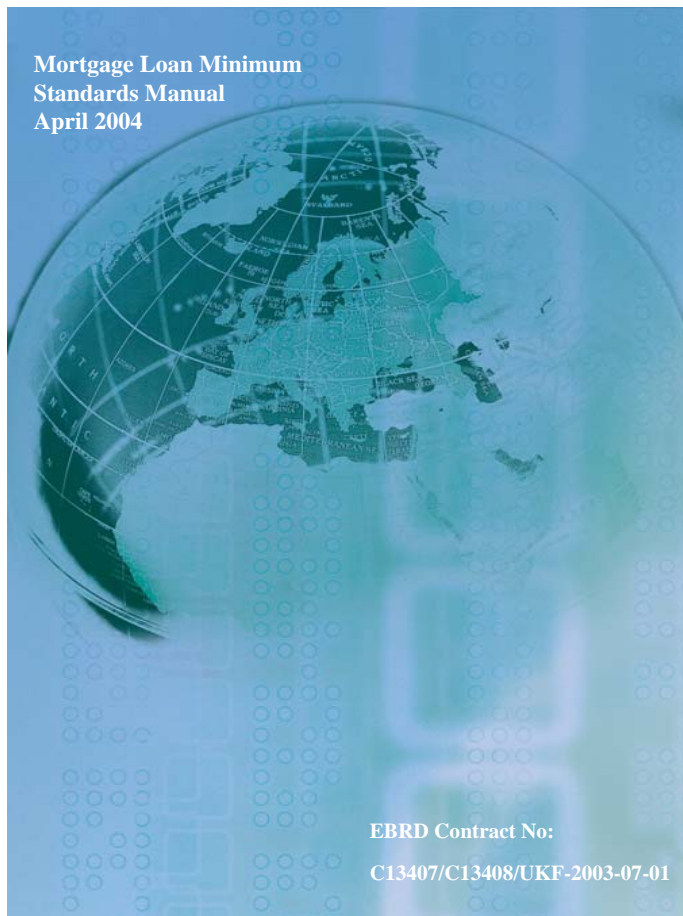
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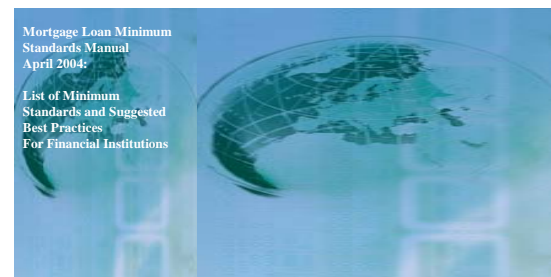
Bank of Ireland 
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1. Final Outputs



List off Minimum Standards and Suggested Best Practice for financial Institutions



Country and Gap Analysis

Main Minimum Standards Manual



CD Rom containing:

- 1) *Minimum Standards Manual*
- 2) *List off Minimum Standards and Suggested Best Practice for financial Institutions*





2. Sample Banks

Croatia

- Splitska Bank
- Privredna Bank

Bulgaria

- Bulgarian Post Bank
- United Bulgarian Bank
- Biochim
- Bulgarian-American Credit Bank

Romania

- Banc Post
- BCR
- Banc Transylvania
- Domenia Credit