3.31 POLAND

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I. FRAMEWORK

The legal framework for covered bonds is mainly determined by:

> The Act on Covered Bonds and Mortgage Banks (*Ustawa o listach zastawnych i bankach hipotecznych*) of August 29, **1997**; ("The Covered Bonds Act"),

> The Bankruptcy Law (*Prawo upadłościowe*) of February 28, **2003**, Chapter II – Bankruptcy proceedings for mortgage banks, Article 442–450a,

> Act on Trading in Financial Instruments (Ustawa o obrocie instrumentami finansowymi) of July 29, **2005**,

> The Bonds Act (Ustawa o obligacjach) of January 15, **2015**.

Applicable key soft law regulations for mortgage banks issued by the Polish Financial Supervision Authority (Komisja Nadzoru Finansowego, the KNF):

> Recommendation F (introduced in 2014) – the standards for determining mortgage-lending value were eased.

> Recommendation K (introduced in 2016) – the rules on keeping and managing cover registers were updated.

In 2015 the Covered Bonds Act has been thoroughly updated in order to increase the safety of the covered bonds and their availability to investors with new provisions coming into force as of 1 January 2016. Among the key modifications were: introduction of statutory overcollateralisation and liquidity buffer and increase of funding limit for residential loans as well as implementation of soft bullet and conditional pass-through structure upon insolvency as well as regular coverage and liquidity testing.

In 2022 the Covered Bonds Act has been amended due to necessity of implementation to the Polish legislation the provisions of the Directive of the European Parliament and of the Council (EU) 2019/2162 of 27 November 2019 on the issue of covered bonds and covered bond public supervision amending Directives 2009/65/EC and 2014/59/EU (the Covered Bond Directive). Key modifications of Covered Bonds Act were:

> extension of catalogue of eligible assets for the issue of a public covered bond,

> inclusion the double recourse mechanism into the definition of a covered bond,

> confirmation under the Covered Bonds Act that maturity extension option of the covered bond is limited only to the bank's event of bankruptcy,

> equal (pari passu) status of cover swap counterparties and covered bond holders in bankruptcy,

> quality requirements on derivatives to be a part of cover pool,

> reduction of cover pool mandatory overcollateralization from 110% to 105%,

> introduction of the concept of "European covered bonds" and "European premium covered bonds",

> extension of bank's reporting obligations,

> detailed regulation on FSA supervision on covered bond issuers

Due to 2022 amendment of the Covered Bonds Act, new Regulation of the Minister of Finance of 22 July 2022 on conducting the collateralisation review and coverage and liquidity tests was issued.

II. STRUCTURE OF THE ISSUER

The issuer is a specialised credit institution (mortgage bank) with the supervision of the Polish Financial Supervi sion Authority. It is required by law that the mortgage bank is a joint stock company with a legal personality (not a branch) with two licenses: a banking license and consent to start operating activity, both granted by the KNF. The two licenses constitute consent to maintain an active covered bond issue program.

The additional covered bond issuer is Poland's only state-owned bank, Bank Gospodarstwa Krajowego (BGK), which may issue covered bonds to finance in particular government programmes. However, there have been no issues of BGK so far.

According to the Covered Bonds Act, a mortgage bank is limited in its range of business activities, i.e. it may only engage in activities specified in a closed catalogue. The operations of a mortgage bank can be divided into two groups: core and non-core, and may be also executed in foreign currencies.

The core operations which may be performed by mortgage banks include:

> Granting loans secured with mortgages;

> Granting loans where the borrower, guarantor or underwriter of a loan repayment is the National Bank of Poland, European Central Bank (ECB), governments or central banks of the European Union (EU) member states, Organisation for Economic Cooperation and Development (OECD member states), or where a guarantee or security is granted by the State Treasury;

> Acquisition of other banks' receivables on account of loans granted by them;

> Acquisition of securities issued by the State Treasury, local government units or BGK (only if securities are guaranteed by the State Treasury);

> Issuing mortgage covered bonds;

> Issuing public sector covered bonds.

Apart from core operations, mortgage bank's approved activities comprise: taking credits and loans, issuing bonds, securities safekeeping, acquiring or taking up shares in other entities, whose legal form ensures that the bank's liability is limited to the value of invested funds, provided that such investment supports the bank's business activities, providing consulting and advice with respect to the property market, managing receivables of a mortgage bank and other banks arising from mortgage-backed loans, as well as granting such loans on behalf of other banks on the basis of relevant cooperation agreements.

A mortgage bank is not authorised to perform any other activities apart from the operations listed above. Particularly, it cannot accept deposits. Such limitations facilitate maintaining a more simplified and clearer activity structure and the specialisation of the loan division as well as the improvement of credit risk assessment methods in the field of real estate financing. Furthermore, funds obtained from covered bond issues shall be used mainly for funding the lending activity of a mortgage bank.

III. COVER ASSETS

Mortgage banks in Poland focus on mortgage or public sector lending. The loans are held on the balance sheet of the issuer and registered in two separate cover registers, which form two separate cover pools.

There are two specific classes of covered bonds which correspond to each of the cover assets:

> mortgage covered bonds (hipoteczne listy zastawne) and

> public sector covered bonds (publiczne listy zastawne).

Both mortgage and public sector covered bonds are direct and unconditional obligations of the issuer and must be fully secured by cover assets of the respective class. Upon the issuer's default, covered bondholders have a dual recourse to a segregated cover pool of assets and, if the cover pool proves to be not sufficient, an unsecured claim against the issuer. Furthermore, the covered bondholders benefit from a statutory priority claim over all the assets in the cover pool equally with counterparties of derivatives entered into cover pool. There is no time subordination: all covered bonds are ranked pari passu.

Pursuant to the Covered Bonds Act, the substitution assets can be included in the cover pool i.e. they may consist of the bank's funds:

> invested in securities issued or guaranteed by the National Bank of Poland, the European Central Bank, the governments and central banks of the Member States of the European Union, the Organization for Economic Cooperation and Development, excluding countries that are restructuring or have restructured their foreign debt in the past 5 years, unless they are basic assets;

> deposited with the National Bank of Poland;

> deposited with domestic banks or a credit institution referred to in Article 18(3)(3) of the Covered Bonds Act.

However, the total nominal amounts of the mortgage bank's claims secured with a mortgage or based on the public sector claims, constituting a basis for the issue of mortgage covered bonds, may not be less than 85% of the total amount of nominal value of outstanding covered bonds.

Hedging derivatives, that meet the requirements set out in Article 18a the Covered Bonds Act, are eligible for the cover pool. Settlement amounts due under such contracts and included into the cover pool rank pari passu with claims of covered bondholders.

In addition, receivables secured by mortgages established on buildings, which are in the construction process, may not in total exceed 10% of the overall value of mortgage-secured receivables in the cover pool. Within this limit, the receivables secured by mortgages on construction lots in compliance with the land-use plan may not exceed 10%.

IV. VALUATION AND LTV CRITERIA

The property valuation in a mortgage bank is conducted under the rules stipulated in the Covered Bonds Act. According to the Polish covered bond legislation, establishing the mortgage lending value of the property shall be performed with due care and diligence on the basis of an expert's opinion. It shall be prepared by the mortgage bank or other entities with appropriate real estate appraisal qualifications commissioned by the mortgage bank. The mortgage lending value cannot be higher than the market value of the property.

Apart from the assumptions laid down in the Covered Bonds Act concerning property valuation in a mortgage bank, there are special banking supervisory regulations (Recommendation F), which stipulate in detail the establishment of the mortgage lending value and impose a duty on a bank to have a database for real estate prices.

The funding limit – related to a single loan – is established at the level of 60% of the mortgage lending value of the commercial property and of 80% in the case of residential property (Article 14 the Covered Bonds Act).

Apart from funding limit, there is also lending limit, according to Article 13(2) the Covered Bonds Act, stipulating that single loans granted or purchased by a mortgage bank cannot exceed the mortgage lending value of the property.

V. ASSET-LIABILITY MANAGEMENT

According to the Covered Bonds Act (Article 18), the total nominal value of all outstanding covered bonds (which should be calculated separately for each class) shall not exceed the sum of nominal amounts of (either mortgage or public sector) covered assets, which form the basis for the covered bond issue. Since July 2022, the ongoing cover principle including 5% mandatory overcollateralisation. That would apply to both public and mortgage covered bonds.

The overcollateralisation is calculated on nominal basis regarding the capital amount of outstanding covered bonds. Additionally, part of the cover pool would be compulsory composed of liquid assets (e.g. central bank eligible bonds), in order to ensure preparation of liquidity buffer, not being a base for the covered bond issue. It is assumed that the value of these liquid assets (liquidity buffer) must be maintained at an amount not lower than the maximum cumulative outflows of net liquidity over the following 180 days. Calculation recognizes final term of covered bonds resulting from soft-bullet structure.

Thus, the nominal value of respective covered assets shall permanently be higher than the total nominal value of the respective covered bonds. In addition, the mortgage bank's income from interest on its respective cover assets may not be lower than the amount of bank's payable interest on its respective outstanding covered bonds.

VI. TRANSPARENCY

Cover pool transparency reports for individual banks are available at their respective websites (see below). Three out of five Polish mortgage banks are holding the Covered Bond Label and publish their reports following the Harmonized Transparency Template.

The majority of Polish covered bonds (public sector and mortgage covered bonds, the latter denominated in PLN as well as in EUR) are listed on the Catalyst, a local bond market operated by the Warsaw Stock Exchange and BondSpot. Both markets are supervised by the Polish Financial Services Authority and are approved as regulated markets by the European Securities and Markets Authority (https://registers.esma.europa.eu/publication/searchRegister?core=esma_registers_upreg#).

Additionally some of Polish covered bonds denominated in both currencies (PLN and EUR) are also listed on the Luxembourg Stock Exchange.

Issuers, whose securities are listed on the regulated market, are legally bound to provide investors with up to date information about their company's economic situation and events which may have an effect on investment risk. Consequently, mortgage banks are obliged to submit disclosures in the form of current and periodic reports, including information on subscription, assigned rating or interest payment dates of covered bonds.

Issuance documents such as Base Prospectus and Supplements for individual series comprising detailed information on the covered bonds as well as the issuer can be found on the issuers' websites:

mBank Hipoteczny: https://www.mhipoteczny.pl/en/investor-relations/issue-programmes/
Pekao Bank Hipoteczny: https://www.pekaobh.pl/emisje-listow-zastawnych/programy-emisji.html
PKO BP Bank Hipoteczny: https://www.pkobh.pl/en/covered-bond/
ING Bank Hipoteczny: https://en.inghipoteczny.pl/inghipoteczny-en/investor-relations
Millennium Bank Hipoteczny: https://www.millenniumbh.pl/relacje-inwestorskie#program-emisji

VII. COVER POOL MONITOR AND BANKING SUPERVISION

One of the key features of Polish covered bond legislation (Article 31 the Covered Bonds Act) is the monitoring role undertaken by the covered pool monitor (*powiernik*) who is appointed by KNF at the request of the mortgage bank's supervisory board. The cover pool monitor is independent and shall not be bound by instructions of the appointing body.

The cover pool monitor is responsible for an ongoing control of the appropriateness of the cover pool management. Its main tasks comprise monitoring of the cover pool (i.e. confirming the accuracy of the inclusion in or removal from the cover register of the cover assets, ensuring that the asset eligibility requirements are met, verifying the correctness of the value registered in the cover pool, etc.) as well as the issuer's compliance with specific provisions of the Covered Bonds Act and reporting any breaches of them to the KNF.

The cover pool monitor is required to perform above mentioned tasks not only on an ongoing basis, but also prior to every issuance of a mortgage bank in order to ensure that a mortgage bank provides an appropriate cover for the planned issue. The issuer is obliged to provide full cooperation to the cover pool monitor and shall give the cover pool monitor the right to review the register, loan documents, accounting books or other bank's documents at its request.

Apart from cover pool's management monitoring performed by the cover pool monitor, mortgage banks fall under the oversight of the KNF which carries out general assessment of Polish banks, including mortgage banks as a part of general banking supervision.

The KNF may commission an independent expert at the expense of the inspected mortgage bank to inspection of the appropriateness of the mortgage bank's entries to the mortgage cover register. This would also include establishing the mortgage lending value of the property was in compliance with the rules referred to in Article 22(5) the Covered Bonds Act.

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

Pursuant to the Covered Bonds Act and the Bankruptcy Law (which is complementary to the former in terms of the insolvency issues, containing a separate chapter: Chapter II – Bankruptcy proceedings for mortgage banks – Arti cles 442-450a), in case of bankruptcy of a mortgage bank the receivables, claims and means entered in the cover register shall constitute a separate bankruptcy estate which may be used exclusively to satisfy claims of covered bondholders and claims under derivative contracts. Moreover, initiation of the insolvency proceedings does not affect covered bonds (*listy zastawne*), i.e. they do not automatically accelerate when the issuer becomes insolvent.

After declaring a bankruptcy of the mortgage bank, the court appoints the curator (*kurator*) who represents the rights of covered bondholders in the bankruptcy proceedings and notifies the total nominal value of outstanding covered bonds together with accrued interest to the bankruptcy estate. In order to perform these duties, the curator has the right to review the accounting books and other documents of the mortgage bank as well as to obtain all the necessary information from the receiver (*syndyk*), court supervisor (*nadzorca sądowy*) and administrator (*zarządca*).

The curator participates in the liquidation of a separate bankruptcy estate, performed by the receiver. If possible, the items of such estate may be sold to another mortgage bank. While maturities of covered bond principal are postponed automatically by 1 year further, during this period all interest payments are executed pursuant to the terms and conditions of the covered bonds. The aim of that solution is to support the timely payment of covered bonds, if a mortgage bank goes insolvent. Additional amendments to the law on bankruptcy include the introduction of the asset coverage test, which verifies whether the separate insolvency estate is sufficient to fully satisfy the claims of the bondholders, as well as the liquidity test, which verifies whether the separate insolvency estate is sufficient to fully satisfy the claims of the covered bondholders on the extended redemption dates. These tests are conducted also during regular activity of the mortgage bank.

With a separate bankruptcy estate, the following categories should be satisfied successively:

> Liquidation costs of the separate bankruptcy estate, which also include the remuneration of the curator, as well as interest and other covered bonds receivables;

> Covered bonds as per their nominal value.

The Polish model, introduced in January 2016, stipulates a statutory soft-bullet structure in case of a mortgage bank insolvency, conditional pass-through payments, as well as detailed regulated scenario for insolvency procedure with clear competences and precise legal tools for action including over-indebtedness and liquidity tests. Transition into both soft bullet and conditional pass-through structures can only be triggered by legally specified events (insolvency and failed coverage tests) with limited decision rights in this respect granted to covered bond holders (possible resolution of covered bondholders with 2/3 majority to sell the separate bankruptcy asset pool to another bank).

After satisfying the covered bondholders the surplus of the cover assets deriving from the separate estate shall be allocated to the general bankruptcy estate. In case that the separate bankruptcy estate does not fully satisfy the cover bondholders, the remaining amount shall be satisfied from the whole bankruptcy estate funds. In that case, the remaining amount shall be transferred from the bankruptcy estate funds to the separate bankruptcy estate funds. It indicates that the covered bondholders are given preference over other creditors.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

In order to apply a preferential risk-weighting for covered bonds, the instrument needs to meet the criteria laid down in the UCITS Directive and the CRR.

Polish covered bonds already meet the criteria of Article 52(4) UCITS: in December 2008 Polish covered bond was notified by the European Commission (EC) as a European "eligible bond" (covered bond), i.e. the instrument with a qualified collateral and can be found on the EC's website at present https://commission.europa.eu/index_en).

Polish covered bonds also fall under the criteria of Article 129(1) of the CRR[1]:

> Substitution assets, including liquidity buffer, comply with Article 129(1)(a-b) CRR;

> Derivatives included in the cover pool may comply with Article 129(1)(c) CRR;

> Residential real estate loans comply with Article 129(1)(d) CRR, LTV limit of 80%;

> Commercial real estate loans comply with Article 129(1)(f) CRR, LTV limit of 60%;

> Portfolio information is publicly available at least on semi-annual basis.

Following recent amendment of the Covered Bonds Act, foreign investors (both private and corporate) are exempt from withholding tax both in relation to coupons and principal amount.

PLN denominated covered bonds are approved by the National Bank of Poland as the instruments eligible for intraday and lombard credit as well as repo transactions. As of April 2023, the haircut levels:

> for repo using covered bonds as collateral are 39% (up to 7 years) – 56% (above 15 years)

> for intraday and lombard credit are 25% (up to 3 years) – 56% (above 15 years)

based on notional value and time remaining to maturity. Haircuts are the same as for corporate and municipal debt.

EUR denominated covered bonds issued under international covered bond programmes, which are eligible for Eurosystem credit operations, but are not eligible for the CBPP.

Polish investment regulations pertaining to investment limits for covered bonds are as follows:

> Banks and insurance companies – no statutory limits, internal concentration limits apply, high-quality liquid asset status depending on outstanding issue amount and rating;

> Open ended investment funds – 25% of assets under management (AuM) limit for covered bonds per issuer, 35% of AuM limit for total exposure per mortgage bank (including unsecured debt and OTC derivatives), 80% of AuM limit for all covered bonds in portfolio;

> Closed ended funds – 25% of assets under management (AuM) limit for covered bonds per issuer;

> Pension funds up to 40% of AuM, 5% per one issuer or issuer's group.

1 For further information on the UCITS Directive and the Capital Requirements Regulation (CRR) please see: https://hypo.org/ecbc/covered-bonds/.

Issuers: mBank Hipoteczny S.A., Pekao Bank Hipoteczny S.A., PKO Bank Hipoteczny S.A., ING Bank Hipoteczny S.A and Millennium Bank Hipoteczny S.A.

COVERED BOND LABEL : PKO Bank Hipoteczny Spółka Akcyjna (1 cover pool), mBank Hipoteczny S.A. (1 cover pool), Pekao Bank Hipoteczny SA (2 cover pools).

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com or via the following QR code: