

## **Serbia First Programmatic Private and Financial Development Policy Credit**

### Triggers for PFPDPC-2: Adoption of Mortgage Law regulations

#### Proposed Convergence Assistance

##### Proposal

To help the borrower meet one of the trigger requirements for continued access to World Bank financing – and to help the Bank increase the developmental effectiveness of its intervention, “Convergence” proposes to provide assistance in the drafting of the set of regulations that will implement the new Mortgage Law.

##### Context

“Convergence” is an innovative financial sector development program that aims at promoting market-building regulatory fine-tuning in collaboration between authorities and market participants. It is administered by the WB Financial Sector Vice Presidency (FSE) with the support of a grant from the Italian Ministry of the Economy. “Convergence” seeks to undertake its analytical assignments in partnership with other institutions and in collaboration with relevant Bank Group units.

##### Why a public-private approach

Developed financial markets experience shows that market development may be unduly constrained by secondary regulations that do not fully reflect the nature and specific constraints of banking operations. This regulatory development process benefits most from active participation of analysts that are able to bring to bear the detailed perspectives of market participants. The analytical and participatory approach that is at the core of the “Convergence” mandate is particularly relevant for the situation at hand.

##### Implementation Modalities

To ensure that mortgage regulations in Serbia do help increase access to finance, and that all banks, irrespective of their shareholder origin, have equal chances to build a viable commercial presence in this growing market segment, “Convergence” proposes to support the analytical work of a public-private working group that will be created to prepare a proposal for mortgage regulations. The material shown in Annex illustrates the variety of topics that require secondary mortgage regulations, according to the Italian experience.

The working group should comprise representatives from the banking industry, independent lawyers, representatives from relevant ministries and official entities. It should make its report available to the senior officials of the public institutions responsible for enactment of these regulations.

##### The “Convergence” Contribution

The “Convergence” support would consist of a dedicated senior professional that would act as Project Leader and Secretary to the public-private working group, assisted by a lawyer with extensive operational experience in legal aspects of mortgage financing operations, possibly related to the Italian Banking Association (such as the author of the Annex). Other members of the “Convergence” team would be available as necessary. The “Convergence” Project Leader would report to the World Bank PFPDPC Team Leader. All expenses incurred by the “Convergence” team to deliver the output would be for the account of the “Convergence” budget. “Convergence” could mobilize this team starting from June 2006.

## **Areas Requiring Mortgage Lending Regulations**

The following are six areas which, in Italy, have proven to be core for the operational implementation of the Mortgage Law and for the development of the mortgage lending market. These areas represent practical concerns for bankers, borrowers, home owners, real estate developers, monetary and tax authorities. They have benefited from extensive market participant involvement through the Italian Banking Association (ABI). They include:

### **1. CREDIT UNDERWRITING:**

Extensive secondary regulations have been issued to guide underwriting procedures.

- REAL ESTATE EXPERTISE/VALUATION: in this area, the priority is to identify uniform regulations for real estate expertises/valuations; ABI has promoted the establishment of a uniform Code of real estate valuation.
- TRANSPARENCY: ABI has worked closely with Bank of Italy to prepare secondary regulations on the mechanisms of supply of mortgages (including distance offers) and the related disclosure requirement and information to consumers and clients on interest rates, advertising, prices and contractual conditions.
- ANTI-MONEY LAUNDERING: ABI has worked with the regulator to produce a significant set of regulations aimed at identifying the typical suspicious operations taking place in this particular industry.
- PRIVACY: also in this case, secondary by laws have been issued to curb the abuse in the abuse of personal data and information and protect consumer privacy;
- CIVIL LAW ISSUES: ABI has strived over the years to ease a number of administrative practices that had proven to be stumbling blocks in the underwriting of mortgage loans such as donations, preliminary transcripts of sales, “cadastre” sale prices, notary relationships, etc.

### **2. CONTRACTS AND FORMS OF FINANCING:**

A lot has been done at the secondary level (regulations, directives) to help with implementing the legislation. This is the case, for example, for the:

- maximum percentage of financing granted;
- additional guarantees;
- techniques in the contractual agreements for financing;
- stages of completion of real estate works; real estate credit and protection of committed purchasers;
- financing prepayment options.

### **3. OPERATIONAL ASPECTS**

In Italy a distinguishing feature is the possibility to acquire somebody else’s debt title. This practice greatly facilitates the repossession of real estate, and, consequently, access to credit.

Aspects that were addressed at the level of secondary regulations were:

- a) the process of ‘liberation’ of the original debtor;
- b) the position of the party replacing the original debtor in the lender-borrower specific relationship;
- c) the fiscal issues impinging on the act of debtor replacement (“accollo”), as well as its accounting treatment;
- d) the procedures for sending payment notices;
- e) the documentation to be sent to the client in the course of the contractual relationship to satisfy bank transparency and disclosure requirements.

#### **4. TAX QUESTIONS**

The most important fiscal issues concerning the mortgage industry relate to the indirect taxation of mortgages. In this area, ABI has specifically engaged the lawmakers and the Ministry of Finance on the following aspects:

1. the applicability of a regime of exemptions and facilitations (and the operations to which such exemptions are applied);
2. Legal and regulatory formalities related to such applicability.

On this delicate matter, ABI has issued many interpretations and has made many proposals to encourage the introduction of tax advantages in the area of medium and long term financing.

#### **5. USE OF COLLATERAL**

Recently in Italy new laws and by-laws have been issued concerning the various kinds of securities that can be issued based on collateralized lending.

#### **6. CREDIT DEFAULT**

ABI has participated in the preparation of the new bankruptcy law, contributing specific suggestions aimed at facilitating credit recovery connected with real estate financing (e.g., system of repossession of security in real estate mortgages).

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