

Notes to the agenda

This workshop is organised by Directorate for Financial, Fiscal and Enterprise Affairs of the OECD, under the aegis of the Committee on Financial Market, within the framework of the transition economies programme of the OECD's Centre for Co-operation with Non-Members and in co-operation with the State Office for Housing and Urban Development, Warsaw, Poland. It will be held in Warsaw on 5-6 December 2002. The discussion will focus on various issues concerning the development of housing finance, including:

- 1) Overview of Developments, Considering Benefits of Housing Finance
- 2) Funding Measures
- 3) Risk Management and
- 4) Consumer Protection

These issues are to be addressed by participants from transition economies, in terms of their efforts to establishing a functioning housing system and market-based housing transactions, as compared with the systems found in OECD Member countries.

The meeting will start at **9:00** on **December 5** and finish at **18:00** on **December 6**.

In each session, speakers will make a presentation for up to **20 minutes**, followed by 30 minutes of general discussion.

Session 1: Overview of Developments, Considering Benefits of Housing Finance

This session will review recent developments in financial markets/systems in transition economies. Basic issues of housing finance will be touched upon, including the advantages of having a well functioning mortgage lending system and the problems to be addressed in establishing an effective system. Housing finance obviously has a public policy aspect, since a housing finance system is an essential vehicle for the provision of the overall housing stock and of social policies to promote homeownership. Meanwhile, as commonly observed in advanced market countries, housing finance markets constitute an important segment of the financial sector in general, and thus, the development of the housing finance market is likely to be a key factor in overall financial development.

Suggested issues for discussion

- What has been the experience of the growth of mortgage markets in transition economies? What progress has been made in building the legislative and regulatory framework? Which forms of finance have been most important? Have inflation, lack of credit history and unclear property rights impeded growth of the market?
- What benefits accrue to transition economies from the development of housing finance? What general lessons can be drawn from these experiences?

- What are the practical difficulties for transition economies in establishing an effective housing finance system? How should they be addressed?
- In the view of participants, what are the main advantages and benefits of a well functioning financial system/market? What general lessons for transition economies can be drawn from the Danish system? What effect does an efficient housing finance market have on other national financial/capital markets?

Session 2: Funding Measures

Adequate funding is an indispensable factor for any housing finance system. It can be said that there are two basic kinds of sources of fund: deposits and securities. In this session, various funding measures will be reviewed and discussed (in Part A), followed by a discussion on mortgage-related securities (in Part B). Naturally, if public funds are not to be the sole source of support for the housing finance system, at least one of these two alternatives must be available to channel public savings (private money and a primary wellspring) to housing finance.

Part A: Overview

The existence of diversified systems of housing finance in advanced market countries and the myriad funding measures which serve them suggest that there is no "one size fits all" model of housing finance that is applicable to transition economies. Part A will review such measures and discuss their features.

Suggested issues for discussion

- What are the recent trends and developments regarding funding measures for home purchases? How does the introduction of the Euro influence these trends (e.g. through an effect on mortgage-bond markets)? What are the possible implications of European financial market integration for fund raising in transition economies?
- Has most mortgage finance taken place through deposit based systems? If so, has this system hindered the development of long-term mortgage finance? Have fixed rate or adjustable-rate mortgages been the rule?
- What are the recent trends and developments in mortgage bond markets? Are bonds and/or securities suitable as funding measures for housing finance systems in transition economies at the present time?
- What are the recent trends and developments in contract savings systems? How do contract savings system work in the context of housing finance systems in transition economies? What are the relative merits and drawbacks of the system?

Part B: Mortgage Bond Market and Securities

Mortgage markets have a long history in advanced market countries, and deposits (as a funding measure) and depository institutions (as lenders) have played a major role in providing housing loans in many European markets. However, funding a long-term asset like mortgages with relatively short-term (and possibly variable rate) funding measures like deposits creates considerable interest-rate risk for the lender, an asset-liability mismatch that has featured in serious problems for mortgage lenders on occasion. It is often argued that the “unbundling” of the four basic mortgage market functions (loan underwriting/accepting credit risks, origination, servicing, and funding), which historically were carried by a single depository institution, is a growing trend and helps to make mortgage markets more efficient. In this context, mortgage bond markets (on-balance sheet approach) and other mortgage-backed securities instruments play an increasingly important role. Part B will discuss these developments, including the essential role of government support (tax and budgetary measures, government guarantees, other legal/regulatory supportive measures) and its evaluation, as well as the role played by institutional investors. Also issues of mortgage-backed securities (MBS) and American-style secondary mortgage markets will be reviewed and discussed, followed by a presentation on the Japanese governmental Housing Loan Corporation’s reform.

Suggested issues for discussion

- What are the respective merits and drawbacks of funding through deposits and through capital markets? What are the preconditions for capital market funding? What types of funding measures may be promoted in transition economies? What are the pre-requisites for properly functioning mortgage bond markets?
- What is the experience of transition economies in developing fixed-income bond markets? What are the difficulties in moving beyond the stage of government debt markets to markets with more varied instruments?
- What should be the fundamental role of government in developing the housing finance sector? What types of measures should the government put into force? How might the views of transition economies differ from advanced market economies in these regards?
- Has government policy favoured one form of finance over others? Should policies be neutral or is one form more desirable?
- What are the features of institutional investors and how can they participate effectively in the housing finance sector? What are the lessons from developed market economies? What perspectives are needed to monitor or regulate institutional investors as regards their *modus operandi* in markets?
- Have institutional investors attained significant importance and have they invested in long term assets?
- Given that mortgage-backed securities thus far have not been popular among European countries, compared with the United States, what can be learned from the system of the US

mortgage markets? What are the recent developments in the US? In the views of participants, how will MBS develop in European and transition economies?

- Japan decided to utilise MBS in order to further activate its private housing loan market. What lessons can be drawn from this decision?

Session 3: Risk Management

This session will review and discuss risk management issues. Several related topics will be touched on, including: (1) mortgage lenders may bear various risks that must be properly managed. These risks range widely from general macroeconomic and legal/regulatory risks to day-to-day operational risks. (2) In many transition economies, the majority of housing is composed of multi-apartment buildings that now require significant maintenance investments in common areas (e.g. roofs, public space, basements, etc.). It is said that without proper maintenance of buildings, because of unclear property title to common areas and the uncertain joint responsibilities of co-owners, the value of individual units (as collateral) is falling, which points to a possible malfunction of finance for maintenance. (3) The new Basel Accord (Basel II) is to be implemented at the end of 2006. Better measurement of risk is one of its main objectives, and issues pertaining to the treatment of residential mortgage and securitisation in the new Accord will be addressed. (4) Mortgage insurance is one of major tools that can be beneficial in mitigating credit risk, meanwhile this instrument requires considerable micro-data. Issues including how mortgage lenders in the transition economies can use mortgage insurance, given the different levels of sophistication and development of their markets, will be addressed.

Suggested issues for discussion

- In the view of participants, what types of risks in financing home purchases are critical to manage? Given the lack of credit history, how can the credit risk of individual borrowers be adequately evaluated? Are “loan-to-value ratios” and “payment-to-income ratios” effective measures in transition economies? How can the risks (e.g. credit, interest-rate, inflation) associated with long-term housing loans best be managed?
- What are the recent developments regarding the condition of multi-apartment buildings in transition economies? To what extent does this problem pose a major obstacle to mortgage lenders? How can the problem be adequately managed? Property rights, valuation techniques, foreclosure procedures?
- How can the government act to remove risk temporarily while encouraging market participants to build risk management skills?
- What are the objectives of the review of the new Basel Accord? What are the implications of the new Accord for mortgage lenders? How will residential mortgage loans and mortgage bonds be treated in the new Accord? How will off-balance sheet securitisation be treated in the new Accord?

- How popular is mortgage insurance in terms of credit risk management in transition economies? What will be the future development in the view of participants? What other arrangements for mitigating credit risk might be suitable for transition economies? What role should the government play in this regard?

Session 4: Consumer Protection

This session will address consumer protection. Generally speaking, consumer protection is one of the key policy areas in a market-based competitive economy. In the context of mortgage relations, consumer protection can cover wide-ranging issues, such as those involved in acquiring clients, advising and informing them, drafting loan contracts, collecting the repayment and ensuring reasonable treatment in case of their default. In addition, housing loans are usually one of the biggest financial commitments most individuals will make. Thus, housing finance is of crucial importance from the borrowers' viewpoint. In European markets, consumer protection related policy has become one of the key issues to be addressed under the impact of the growing free trade of goods and services. However, various European countries have their own procedures. Denmark, for example, has a long history and sophisticated system in this regard.

Suggested issues for discussion

- What consumer protection measures have been implemented in the area of housing finance? What are the recent developments in transition economies in this regard?
- What are the features of the Code of Conduct for Pre-contractual Information, a measure taken by the EU? What lessons can be drawn from Denmark's experiences?

Concluding Session

The main purpose of this session is to review the discussion and the exchange of views for the two days and to consider possible future work in a frank manner. Representatives from transition economies will be encouraged to make their comments, and then the floor will be open to all participants.