



Legal Alert

Banking, Finance and Restructuring

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Second chance for bank sub-participation in Poland

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1. Background

The Polish securitization market for performing loans has in fact been frozen for some time and is still waiting for the amendments to wake it from its slumber. The potential of this market is huge - the market players' expectations are perfectly in tune with the market's potential. It seems that the market may come alive and begin to achieve its potential shortly.

A special working group appointed by the Polish Financial Supervision Authority prepared a detailed analysis of legal obstacles to development of the public market for long-term commercial debt instruments and suggested ways of eliminating the obstacles.

The issue is that under Polish law a bank may enter into a sub-participation agreement only with an investment fund or a securitization fund and, most importantly, that the agreement must not contain any provisions for deferred payment or payment in installments for transferred rights. This has been considered as a deal breaker for such transactions, mainly for tax reasons.

2. Amendment

At present, a bank that wishes to transfer rights to income from receivables under a loan facility to a securitization fund by way of a sub-participation agreement recognizes revenue at the time of transfer and pays the income tax in one go. Also under the current regulations, this tax burden cannot be mitigated, for instance by payment in installments or deferred payments. On top of that, banks cannot recognize tax-deductible costs at the moment of transfer. Tax-deductible costs must be spread over time and match the partial loan repayment by each borrower. This is currently making any sub-participation unattractive from the tax perspective and literally freezing the market.

The aim of the amendment is to make sub-participation more attractive for Polish banks by changing the moment of recognition of their revenue in the sub-participation transaction. It stipulates that for tax purposes timing of revenue will be matched to the timing of tax-deductible costs, i.e. the revenue will be recognized by the bank not at the moment when the bank actually receives the payment from the fund but at the time when the principal of the loan is due or at the time it is repaid, if this occurs before it is due to mature.

As a consequence, Polish banks entering into sub-participation agreements will not bear the burden of tax at one specific point in time, which is, most importantly, not matched to the moment of recognition of tax-deductible costs. This significant change will hopefully render the sub-participation more attractive for the market players.

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3. Market impact

The purpose of the amendment is to make bank sub-participation economically viable. This should encourage banks to perform such transactions and develop the performing loan securitization market in Poland.

Should the amendment encourage increased use of sub-participation agreements, banks will also gain another tool to match the time schedules for servicing their assets and liabilities. This may help them to mitigate risks regarding liquidity and comply with capital adequacy requirements of Basel III.