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Republic of Croatia
Ministry of Finance
Mr. Ante Žigman, State Secretary

Zagreb, 19 December 2006

Dear Sirs,

Report on the Draft Croatian Securitization Law dated 12 December 2006

1 Introduction

The Steering Committee on its meeting held on 30 August 2006 (i) mandated Porobija & Porobija Law Firm (hereinafter: the Independent Legal Advisors or ILA) to prepare the Consultation Document as a basis for international market consultations and (ii) appointed the legal drafting team (hereinafter: the Legal Drafting Team or LDT) comprising of representatives appointed by the Ministry of Finance, the Croatian National Bank, the Croatian Agency for Supervision of Financial Services and the Croatian Banking Association.

Following draft Guidelines for Drafting the Law on Securitization made available by ILA to the LDT on 22 September 2006, publication of the Securitization Law Consultative Document prepared by the Independent Legal Advisors and after having obtained feedback from certain market participants with respect to the issues raised in the Consultative Document, the Independent Legal Advisors has issued the Final Guidelines for Steering Committee approval that consisted of (i) the principles approved by the Steering Committee on its meeting held on August 30, 2006 and (ii) certain principles that are presented there as a result of, among others, the feedback from market participants to the issues raised in the Consultative Document.

On the basis of the Final Guidelines, the Legal Drafting Team has provided the draft Securitization Law (hereinafter: the draft SL), in order for the Independent Legal Advisors to be able to provide legal opinion on such draft law and for the Steering Committee to consider such draft law before it is released by the Ministry of Finance for broader consultations by the relevant regulators.

Legal Drafting Team distributed the initial draft Securitization Law ("0" draft) to the Independent Legal Advisors on 13 December 2006 for their first review of such draft.

In fulfilling their task, the Independent Legal Advisors, reviewed the draft Securitization Law, analyzed the provisions contained therein and produced this report containing comments, views and recommendations related to the draft Securitization Law.

Taking into consideration the very short period of time between circulation of documentation between ILA and LDT and the fact that the ILA consider the draft SL to be in its early stage, the ILA views and comments contained herein do not attempt to be exhaustive, but more of a general nature and only in certain cases focused on the relevant details.

Following the Steering Committee's meeting to be held on 22 December 2006 and delivery of the next draft Securitization Law (that would reflect the Final Guidelines approved by the Steering Committee, comments and suggestions presented herein and possibly the outcome of the next round of consultations with the relevant Croatian authorities), we would gladly provide the Steering Committee with a final opinion on the final draft Securitization Law prepared by the LDT.

2 Content

This Report contains general remarks regarding compliance of the draft SL with the Final Guidelines and points out the issues to be further developed and/or introduced in the draft SL in order for the draft SL to comply with the principles contained in the Final Guidelines. It also contains certain detailed comments regarding some of the provisions of the draft SL.

3 ILA report on the draft SL

3.1 Structure of the draft SL

Generally speaking, structure of the draft SL reflects to a certain degree the structure suggested by the Final Guidelines. However, certain parts of the draft SL dealing with the most important issues related to the securitization have not been sufficiently developed so far (e.g. taxation, bankruptcy remoteness, data protection).

In addition, in order for the draft SL to be more comprehensive and user-friendly, we would suggest certain regrouping of the articles within the draft SL (e.g. all provisions related to the securitized assets should be grouped together) and grouping of the related provisions in chapters.

In order to avoid any uncertainties as to interpretation of the law, we advise that the accepted terminology is consistently used throughout the draft law.

Regarding the secondary regulation mentioned in the Final Guidelines, it should be noted that the draft SL does not define the main principles and the issues to be subject to secondary regulation.

3.2 Definition of the securitization transactions

The definition of "securitization" given by the draft SL is wide enough to cover both true sale and synthetic securitization transactions.

The definition refers to the "transfer of **commercial** risk from the securitized assets" and it is our opinion that the definition should use the "transfer of the risk arising from or related to the securitized assets" without being unnecessarily explicit as to the nature of the risk being transferred.

Number of provisions dealing e.g. with the definition of the securitized assets, segregation thereof, statutory pledge over the securitized assets, etc. are drafted by having in mind the true-sale securitization and not taking into consideration specifics of the synthetic securitization. Namely, the draft SL is not consistent in taking into account synthetic securitization, where the segregation of the securitized assets occurs at the level of the originator and not the securitization undertaking.

3.3 Originator

Current definition refers to the originator as a legal entity disposing of its assets for the purpose of securitization. Having in mind the definition of the synthetic securitization, using "the transfer of the assets to the SPV" or "disposal of the assets" in the definition of the originator may be inconsistent with such definition.

3.4 SPVs – securitization companies and securitization funds

Generally speaking, the draft SL complies with the Final Guidelines regarding the types of the securitization undertakings. However, certain number of issues remained under-regulated and/or unclear.

Definition of the securitization undertaking could be interpreted as restrictive for transactions in which there would be two securitization undertakings, i.e. the acquisition SPV and the issuing SPV. As pointed out in the Final Guidelines (recognizing those are yet to be approved by the Steering Committee), there may be a number of reasons why a particular transaction would envisage having an SPV for the purchase of the securitized assets (or risks connected thereto) and a separate SPV to issue the asset-backed securities. These structures are normally used to isolate the risk and maximize the performance to the extent possible of each of the SPVs. We see no reasons why the Securitization Law should not envisage this structure as well (for example, for the purpose of applying the Croatian segregation / statutory lien rules upon an SPV incorporated in Croatia, but at the same time delegating the issuance of the securities in the international market to a specialized SPV incorporated abroad).

Article 8 paragraph 2 of the draft SL implies that (i) the securitization companies and the securitization funds could not participate in the synthetic securitization, and (ii) only originators could act as securitization undertaking in the synthetic securitization. Reasoning behind such restrictive approach remains unclear, and thus, in our opinion, should be amended in order to allow the securitization companies and the securitization funds to participate in any type of securitization transaction.

The draft SL does not adequately deal with the single-issuance and multi-issuance structures, as it prescribes that the securitization company could perform only one securitization at the time. It remains unclear what is actually meant by "one securitization at the time", i.e. does this mean that until the securities issued in the course of one securitization (and covered by one prospectus) are not repaid, the securitization company is not authorized to be engaged in another securitization. If that is the intended meaning of this provision, we believe this provision should be made more straightforward in order to avoid any doubts as the interpretation thereof.

Conditions under which the re-sale of the securitized assets and re-transfer of the transferred risk could be performed are not envisaged by the draft SL.

Regarding the licensing and supervision of the securitization undertakings (and other participants in the transactions), it is our opinion that the concept of the securitization register operated by the regulator, whereby the participants of the securitization transaction are registered and, following such registration, authorized to render particular services/provide relevant activities within the securitization structure (such as purchasing of the securitized assets in a true sale securitization, issuance of the securities, servicing of the securitized assets, etc.) without a need to go through any kind of prior licensing procedure

(with exception to the servicers not being banks or originators) would be welcomed by such participants and would actually be in line with the recommendation of the European Securitization Forum.

Currently only one article (Article 47) of the draft SL deals with the general principle according to which the securitization participants and securitization transactions are subject to the supervision of the regulator, with the aim to monitor whether the securitization participants continue to fulfill the prescribed requirements following their entry into the securitization register.

However, the draft SL does not contain requirements regarding e.g. approval of the management rules, supervision with respect to persons acting as management board members of the management company and supervisory board (if any), ordering of the audits of the fund and the company, reporting for statistical and supervisory purpose, etc, so as a consequence thereof it is unclear what would actually be the scope of potential supervision.

The LDT should develop additional, more detailed provisions related to the requirements, as well as supervision, measures and actions available to the regulator for ensuring compliance of the securitization participants with the SL and related secondary regulation (if applicable).

3.5 Assets

The securitized assets are defined as object of the securitization consisting of assets **or risks** arising from the assets in respect of which the securitization transaction is conducted. Such definition implies that the securitization assets are in each case the assets transferred to and owned by the SPV, while we believe this is not the case with synthetic securitization.

Namely, in case of the synthetic securitization, the securitized assets are e.g. receivables that remain owned by the originator and only the risks arising from such securitized assets are transferred to the SPV. Therefore, such "transferred risk" is not "securitized assets" as such term is commonly used by market participants. Instead, in synthetic securitization, securitized assets are the assets underlying the risk transferred to the SPV.

Regarding the segregation of assets by way of statutory pledge, it would be helpful if the draft SL would provide answers to the questions like: what would happen in case any third party acquires pledge over the securitized (segregated) assets of the SPV (e.g. contractual pledge) and enters such pledge in the registry held by FINA; what would be relation between the statutory, contractual and court pledge created over such assets; who would have statutory pledge over securitized assets in synthetic securitization; how would the statutory pledge become public and how would it be enforced. In addition, the draft SL prescribes certain technical details related to the segregation of the assets, including a requirement that the securitization undertaking is obliged upon request of the investors and fiduciary representative to issue a certified list of securitized assets, such assets being considered as "reliable document" (vjerodostojna isprava), but the draft SL does not further elaborate the meaning and purpose of such document.

Final Guidelines suggested the concept of the securitization register should be considered more closely, for the purpose of achieving isolation of the assigned assets from the legal reach of the originator and its creditors, making public the assignment of the assets with respect to the debtors and other interested parties and potentially achieving the registration of the transfer to the SPV of all ancillary rights attached to the assets without complying

with any additional formalities and registrations. Draft SL contains provision on securitization register but this concept as currently drafted is used for a completely different purpose.

Article 28 paragraph 3 of the draft SL prescribes that the list of transferred assets should contain **precise** data for identification of each part of the assets. We believe that this wording could imply that the assets transferred within the securitization transaction should be described in even more precise details than in case of any other assignment/transfer of assets. It is our opinion that, having in mind the size of securitization transactions and the scope of the assets usually transferred in this kind of transactions, the requirements for the description and identification of the assets subject to the securitization should be minimum so as to enable identification of the assets, i.e. without requiring unnecessary details of the assets (e.g. "all receivables due by the borrowers and arising from the mortgage loan agreements bearing identity number xxxx to yyyy executed in the period from 1 January 2003 and 31 December 2005", instead of listing name and surname of each borrower and date of execution and number of each mortgage loan agreement executed by the originator and the relevant borrowers in the same period).

3.6 Securities

With respect to the question raised by the LDT whether in case of securitization fund the investors would actually be unit-holders or holders of the debt securities issued by the fund or the management company, we believe that the law should envisage (i) option for the investors to invest in the units in the securitization fund, such units issued by the management company and (ii) option for the investors to invest in the debt securities issued by the management company on behalf of the securitization fund. Statute of each particular fund should contain rules about whether the units and/or the debt securities could be issued in respect of that particular fund, and the law should leave open to the market participants the choice of using the relevant securities. Units of the fund should explicitly be considered as securities, in line with Article 92 of the Investment Funds Act. Due to the lack of legal personality of the fund, we question the concept in which the fund would issue the securities directly.

We believe that the SL should not impose restrictions on type of securities to be issued in the securitization transactions by the securitization company.

The draft SL should be amended by adding provisions on the content of the prospectus related to the issued securities and the statute of the fund. Such provisions could be based on the corresponding provisions of the Investment Funds Act, taking into consideration particularities of the securitization transactions.

Depending on the views of the Steering Committee, the draft SL would have to be amended in order to contain provisions dealing with ratings of the securities.

3.7 Servicer

Regarding article 21 of the draft SL and having in mind the Final Guidelines, it would be advisable for the draft SL to prescribe that the regulator would be authorized to adopt secondary regulation prescribing terms and conditions under which other legal entities (apart from the originators and licensed credit institutions) would be able to obtain the regulator's approval for rendering servicing activities. That way the draft SL would not be in contradiction with demands of the market in case of possible future evolution of the servicing activities.

As pointed out in the Final Guidelines, having in mind views and practice of certain Croatian commercial courts and their judges that collection of the receivables of another person is considered as "providing legal services" and thus could only be done by the attorneys at law, we strongly suggest that the draft SL contains provision stating that the rendering th servicing activities (as a whole and any part thereof) shall not be considered as providing legal advise, if such services are rendered in accordance with the SL.

In addition to the banks, we would suggest the draft SL to provide a possibility that other "credit institutions" governed by special laws also provide servicing activities if envisaged by such laws.

On the basis of the Croatia Code of Obligations, the servicer as being mandated for the servicing activities would have a statutory pledge over collected funds. Having in mind that the investors would also have statutory pledge on the same funds on the basis of the SL, it would be necessary the draft SL to deal with this issue.

3.8 Bondholders' meeting and fiduciary representative

Pursuant to the Final Guidelines, the draft SL should prescribe that the bondholders' meeting and fiduciary representative protect interest of the holders of the debt securities issued by the securitization company and/or securitization fund management company. Securitization fund management company should act in the interest of the holders of the fund's units.

In addition, the draft SL should clearly prescribe that the statutory provisions about the bondholders' meeting and fiduciary representative apply, unless terms and conditions of the issued securities set out scope of their authorities, rights and obligations differently.

It is our opinion that at this stage the fiduciary representative should not be envisaged as a new type of professional in the financial sector, to be subject to e.g. certain specific licensing and supervision requirements and/or capital requirements. Instead, it seems reasonable to authorize e.g. the authorized companies as defined by the Securities Market Law to perform such activities.

3.9 Tax treatment

Article 49 of the draft SL contains single provision stating that "transfer of the securitized assets is not VAT taxable".

Having in mind a number of complex tax issues that could arise in the course of the securitization transaction, as indicated in the Final Guidelines, the draft SL does not sufficiently cover relevant tax aspects applicable to the securitization transactions.

Without attempting to be exhaustive, following are the questions to which the SL should provide explicit answers (i) is a transfer of risk and/or providing services of protection from the transferred risk in a synthetic securitization VAT taxable, (ii) could the payment of interest to the SPV become subject to VAT as a result of change of the creditor (e.g. SPV as a creditor of the loan receivables instead of a bank), (iii) could the payment of interest to the SPV become subject to withholding tax as a result of change of the creditor (e.g. foreign SPV as a creditor of the loan receivables instead of a bank), (iv) would a foreign SPV be considered to have a permanent establishment in Croatia as a result of e.g. holding securitized assets of Croatian origin, servicing of such assets by Croatian servicer, or similar.

3.10 Bankruptcy remoteness

Draft SL should be amended in order to contain features useful for achieving bankruptcy remoteness of the SPV, as proposed in the Final Guidelines. Examples of the provisions that should be included in the draft SL are as follows: limited recourse clauses (i.e. clauses whereby a source for payments of certain monetary claims of e.g. investors is limited to certain assets instead of the whole assets of the debtor (SPV)), prescribing conditions for the true-sale characterization of the assignment contract, encouraging unvoidability of arm's length assignment of receivables (including future receivables), i.e. ensuring that the transactions being in compliance with a definition of true sale assignment cannot be challenged by the originator's creditors or bankruptcy administrator unless they can demonstrate that the transaction was a fraudulent conveyance, preventing bankruptcy manager of the originator from interfering with cash flows arising from the securitized assets, preventing the cash flows related to the securitized assets to be part of the bankruptcy estate of the originator/servicer (right of separation for the benefit of SPV), recognizing the right of the SPV to unilaterally change/terminate collection arrangements with originator/servicer immediately following the opening of bankruptcy procedure thereof, etc.

3.11 Scope of application of national law

Final Guidelines emphasized the need for the draft SL to contain explicit provisions allowing the transactions with one or several foreign elements, such as recognizing non-Croatian SPVs, issuance of the securities by Croatian SPV abroad, assignment agreement to be governed by foreign law, etc, as well to provide conflict of laws rules with respect to certain situations specific for the securitization transactions.

Current draft SL does not contain explicit provisions recognizing such foreign elements and situations. Moreover, certain provisions of the draft law could even be interpreted to imply non-recognition of such foreign elements.

For example, article 24 paragraph 2 of the draft SL envisages the registration of the securitization fund only together with the adoption of the regulator's resolution on approval of the asset backed securities' prospectus – it remains unclear what would happen if e.g. the Croatian securitization fund issues the securities abroad, in which case the regulator would not be in position to decide on approval of the prospectus. The same article of the draft SL envisages the registration of the servicer only together with the adoption of the regulator's resolution on approval of the asset backed securities' prospectus. Consequently, registration of the servicer and its authority to render services remain unclear in case of securitization of the assets of a Croatian originator where the securitization undertaking would be incorporated abroad and would issue securities also abroad so that the Croatian regulator would again not be in position to decide on the prospectus.

Article 28 of the draft SL prescribes that the transfer of the assets from the originator to the SPV is exercised on the basis of an agreement made in accordance with the SL, **general rules of law on obligations** and special provisions governing transfer of particular assets. This provision is ambiguous as it could be interpreted that the governing law for the transfer of assets has to be Croatian law. Namely, the law could prescribe obligatory contents of the agreement, but should not make impossible for the parties to agree on the foreign law to

govern the assignment agreement (provided this is possible under the general conflict of laws rules). In order to avoid such interpretation, this provision should be revised.

3.12 Data and consumers protection rules

We are of opinion that article 48 of the draft SL should be amended in order to prescribe that not only data about the securitized assets are subject to data secrecy rules, but also the data about the debtors of such assets.

Contrary to the Final Guidelines, the draft SL does not provide any provision that would adequately deal with the obstacles posed by the Consumers Protection Law (i.e. a requirement to obtain an explicit written approval of the consumer for transfer of the data) and the existing obstacles should be adequately removed by the draft SL.

3.13 Recharacterization risk

Draft SL should be amended in order to contain specific provisions on requirements for an assignment to be considered as a true-sale.

In the forthcoming period, the LDT will need to consult extensively with relevant Croatian Authorities with a view of taking a final position on various legal issues and drafting the final SL.

Kind regards,

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