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

Zagreb, 8 June 2007

Dear Sirs,

Report on the Draft Croatian Securitization Law dated 6 April 2007 (the Draft SL)

Introduction

The Steering Committee on its second meeting held on 22 December 2006 mandated Porobija & Porobija Law Firm (hereinafter: the Independent Legal Advisors or ILA) to prepare the opinion on the draft Croatian Securitization Law to be prepared by the appointed 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.

In addition to the Final Guidelines for Drafting the Law on Securitization, please note that the Draft SL has been prepared also on the basis of (i) the report of the ILA dated 19 December 2006 containing ILA's comments the regarding the "0" draft Securitization Law prepared by the LDT, (ii) the comments on the "0" draft Securitization Law provided by KfW and (iii) a phase of intensive work of the LDT aimed to complete the draft law.

In fulfilling their task, the ILA reviewed the Draft SL, analyzed the provisions contained therein and produced this report containing their comments, views and recommendations related to the Draft SL.

This Report is structured so as to provide in respect of the main components of the Draft SL (a) a discussion of the harmonization of the principles actually incorporated in the Draft SL with the Final Guidelines (including to a certain extent the comments and the suggestions received from ESF and KfW) and (b) specific analysis on how to achieve greater compliance of Draft SL with the Final Guidelines, including an overview of more technical issues arising from the analysis of the Draft SL, highlighting the specific instances where the Draft SL departs from the Final Guidelines.

The Report also contains a summary table indicating the specific provisions of the Draft SL that, according to ILA views, require additional drafting, aimed to provide additional guidance to the LDT in the next phase of the legal drafting work.

We hope that by preparing this Report and by emphasizing (i) the technical issues that should be dealt with in the next draft SL and (ii) the principles and provisions contained in the Draft SL Law that may cause significant difficulties to the potential securitization participants in the future and thus may have negative impact to the actual benefit of the SL in practice, we have managed to contribute to adopting the Securitization law that would represent solid basis for the securitization transaction to be arranged in Croatia in the near future.

We are in the progress of updating the Final Drafting Guidelines to incorporate the LDT experience in drafting the law whenever we deem their choices to be consistent with the prior technical work. We believe that the Revised Final Drafting Guidelines are an important reference document for the authorities as the draft law starts its official approval procedure.

Kind regards,

Boris Porobija

Željka Rostaš Blažeković

Schedule

Overview of the compliance of the Draft SL with the Final Guidelines

1. Structure of the SL

1.1 General

Generally speaking, structure of the Draft SL has been very well organized, which makes the Draft SL user-friendly and the Draft SL deals with most of the issues listed in the Final Guidelines.

With respect to the scope and the concept of the SL as suggested by the Final Guidelines, the Draft SL differs from the principles contained in the Final Guidelines in a way that, inter alia, it does not mention the secondary regulation, and it may be useful that certain flexibility is allowed by the Draft SL in order to prevent the SL from becoming inflexible to market innovations. Nevertheless, as emphasized by the Final Guidelines, the SL should limit in scope such secondary regulation, by prescribing main principles and specific issues to be covered by such regulations. Secondary regulations would be very much welcomed particularly with respect to the regulatory capital treatment for financial institutions originators, and especially in circumstances of not having the Basel II Accord implemented in Croatia. In addition, it should be noted that the role and qualifications of the rating agencies are to be prescribed by the listing regulations of the relevant stock exchange. It would be advisable if a deadline for adopting such regulations would be defined or at least agreed between the relevant stakeholders.

1.2 Specific issues

We note that the Draft SL does not contain relevant provisions dealing with taxation, but we understand that despite the Final Guidelines, there has been a strong resistance of the tax authorities to the idea of the tax issues being prescribed by a non-tax regulation. In principle, we agree with such approach provided the relevant tax laws will be amended in order to deal with certain outstanding tax issues in an adequate way and/or the tax authorities will issue official opinion(s), where possible, thus providing potential securitization participants with necessary legal certainty. Non-exhaustive list of the outstanding tax issues was included in the ILA's report of December 19, 2006.

2. Terminology and Definitions

2.1 General

Proposed definition of the securitization and the types thereof mainly satisfy the principles contained in the Final Guidelines.

In order to avoid any possible uncertainties as to interpretation of the law, we advise that the accepted terminology is consistently used throughout the draft SL (e.g. securitization undertaking: article 29 paragraph 2; investors: article 43 paragraph 4, etc.).

2.2 Specific issues

Although the Final Guidelines suggested the provisions allowing the asset-backed commercial paper programmes should be included in the Draft SL, the LDT decided not to introduce the relevant provision in the Draft SL, but instead it decided to leave that to the amendments to the Securities Market Law. Therefore, at this stage it is not clear if and when such programmes would become available under Croatian law. It is our opinion that this and similar issues could have been dealt with by including a general provision in the Draft SL allowing such and similar structures and leaving the technical regulation, to the extent necessary, to the secondary legislation.

Definition of the securitized assets does not correspond to the way this definition is used in the context of other provisions of the Draft SL and thus we believe it should be revised in order to be in line with the following:

"*Securitized assets are assets subject to securitization and which are either (i) transferred in the course of the transaction or (ii) which are underlying assets for the credit and/or others risk or exposure that is being transferred in the course of transaction."*

or in Croatian:

"Sekuritizirana imovina je imovina u svezi s kojom se provodi sekuritizacija, bilo prijenosom same imovine, bilo prijenosom kreditnog i/ili drugog rizika odnosno izloženosti koji proizlaze iz sekuritizirane imovine."

As pointed out by KfW, the definition of the securitization transactions should not refer to the credit risk only, as that may allow for an interpretation that would preclude the transfer of other risks (e.g. interest or currency risk) relating to the holding of assets.

The current definition of the securitization undertakings refer only to the acquiring and disposing of the securitized assets, while it should also refer to the credit (and/or other) risks, in line with the definition of the securitization.

3. Securitization undertakings - Special Purpose Vehicle (SPV)

3.1 General

Draft SL follows the principles related to the form of the securitization undertakings as approved by the Steering Committee, and allows (a) participation of intermediary

SPVs (i.e. it envisages existence of both acquisition and issuing SPVs) and (b) multi-seller transactions (i.e. transactions whereby different originators would be involved).

Final Guidelines outlined briefly the main principles of the regulator's supervision of the SPVs and the SPV fund management companies. The Draft SL does not contain any provision dealing with that very important issue, and it is expected the next draft SL to be expended with the relevant provisions to be drafted by HANFA. The scope of supervision to be proposed could certainly have a great impact to the whole SPV concept, which potentially makes the drafting thereof a very sensitive issue.

3.2 Specific issues

Contrary to the Final Guidelines and suggestions of ESF and KfW, the Draft SL allows only single-issuance SPVs. Although we agree with the aforementioned suggestions that allowing the multi-issuance SPVs would have many benefits, the fact that the LDT decided not to follow those suggestions is not likely to result in any major difficulties for the potential securitization participants.

Despite the fact that the Final Guidelines suggested that the re-sale of the relevant pool of assets should be permitted under flexible conditions, the Draft SL provides rather restrictive requirements, argument for that being the infancy stage of the market and the importance of the investors' protection. We believe the requirements for the re-sale as currently envisaged should be made more flexible, and one of the reasons for that would actually be the investors' protection. That would particularly be the case in case the replacement or resale of the assets would be needed due to downgrade, default or inadequacy of the assets in order to prevent the deterioration of the assets or to generate a higher return for investors.

4. Assets

4.1 General

Draft SL basically accepted the main principles approved by the Steering Committee with respect to the securitization assets, but without actual removing potential restrictions related to certain types of assets that may be imposed by any other Croatian law. In other words, receivables and assets that cannot be assigned, transferred and pledged remain outside the scope of the Draft SL. Although this is contrary to the Final Guidelines and the recommendation of the ESF, we believe the view of the LDT that removing of potential restrictions could at the end result in substantial delay in passing of the SL due to a debate that may be caused by such approach, could be reasonably accepted and thus such inconsistency of the Draft SL with the Final Guidelines does not seem to raise material issues at this stage of the securitization market development.

4.2 Specific issues

In order for the Draft SL to be in line with the Final Guidelines, ILA's view is that the following provisions should be reconsidered and revised by the LDT because as currently drafted they impose restrictions that, pursuant to the opinion of ILA, could have negative impact to the securitization transactions without any actual need or justification:

a) Article 23 paragraph 1 of the Draft SL implies that the assignment agreement (related to the securitized assets) should be governed by Croatian law. We see no legal grounds for such provision, especially in cases where provisions of the Croatian conflict of laws rules allow the assignment agreement to be governed by foreign law (e.g. Croatian SPV entering into assignment agreement with a foreign originator related to the securitization of non-resident assets);

b) Article 23 paragraph 3 of the Draft SL prescribes that the assignment agreement has to contain the list of all securitized assets being transferred with precise data necessary for identification of each part thereof. That provision may imply that the assignment agreement should contain even more data about the transferred assets than it would be necessary under currently valid Croatian laws of general application. If such interpretation would prove to be correct and accepted in the practice, it would be very burdensome for the securitization transactions. Namely, for practical reasons and due to the fact that one securitization transaction could refer to thousands of contracts and related receivables, the SL should either be silent on this issue, or it should contain provision that would facilitate the securitization by imposing requirements related to identification of the assigned assets that would be as minimal as possible.

c) Article 28 paragraph 1 of the Draft SL implies that e.g. a mortgage granted as security for the payment of the receivables that form part of the securitized assets is considered to be transferred to the SPV only following the registration of the SPV as the mortgagee in the land registry, which is not correct. Namely, the transfer of the mortgage occurs *ex lege* with a transfer of the receivables, but such transfer would need to be registered in the land registry at the latest prior to the foreclosure over the relevant real estate;

d) Article 34 of the Draft SL deals with the satisfaction of the investors' claims from the securitized assets. It seems that this provision does not deal adequately with the satisfaction of those claims in case of synthetic securitization, in particular having in mind the issue of the definition of the "securitized assets" as currently drafted in the Draft SL.

e) Article 36 of the Draft SL introduces the segregation of the securitized assets, by way of creating the statutory pledge for the benefit of the investors. Creation of the statutory pledge over the securitized assets is also prescribed for the benefit of the servicer(s) for its(their) claims against the SPV for the due fees and costs. The ILA believe that the creditors other than the investors should be excluded from the

possibility to enforce their claims from the securitized assets and/or to have liens on such assets, because otherwise it could not be excluded that such creditors could, by starting the enforcement over the securitized assets, even actually "accelerate" the claims the investors have towards the SPV on the basis of the issued debt securities.

In addition, there are other issues closely related to the statutory pledge concept that may require additional drafting such as (i) limiting the possibility of each investor as the pledgee to start individual court procedures against the SPV and the pledged securitized assets, (ii) improving the status of the statutory pledgees in case of a need to start court procedure(s) in order to satisfy their claims from the proceeds of the securitized assets, (iii) protecting the status of statutory pledgees in case other court and/or notary public security interests would be created over the same securitized assets, etc.

5. Securities

5.1 General

Draft SL implies obligatory rating for the whole issue of the securities issued in the context of the securitization transaction in order for them to be listed in the first quotation of the Croatian stock exchange. This provision is contrary to the views presented in the Final Guidelines, as well as contrary to the recommendations of the ESF and KfW. Namely, imposing such mandatory requirement would result in significant increase of the transaction costs (due to the costs related to the rating procedure) and would certainly extend the time needed for completion of the securitization transaction. Moreover, it would make impossible listing in the first quotation of certain otherwise quality securities, simply because there would be e.g. so-called first loss piece tranche issued within such issue that would not be rated. In addition, there does not seem to be any valid reason for introducing such discriminatory elements applicable solely to the securitization securities. We would strongly suggest the said requirement to be removed for the securities issued in relation to the securitization transaction.

The Draft SL introduced a concept whereby the securities issued in the context of the securitization transaction undertaken by the securitization fund are issued by the securitization fund itself, although such securitization fund is not a legal entity. ILA believes such concept may cause certain difficulties and ambiguities and thus suggests that the Draft SL is amended by stating that the debt securities issued in the context of the securitization transaction undertaken by the securitization fund are issued by the securitization fund management company acting in the name of the management company and on behalf of the fund.

5.2 Specific issues

Article 44 paragraph 6 of the Draft SL contains a provision that provides the regulator with certain authorities that could be interpreted extremely extensive and that do not exist as such under other relevant laws and regulations dealing with the

securities/investment funds in general. Therefore, we would strongly recommend to delete this provision, in which case article 22 paragraph 5 of the SML would still apply to the securities issued in the course of securitization transaction, and as a consequence the regulator would have the usual authorities in that respect and thus the securities issued in the context of the securitization transaction would be subject to the same regime as any other debt securities.

Even in case the LDT would decide not to delete this provision, it should be revised in order at least not to be contradictory. Namely, in the first part of this provision refers to the circumstances that are commonly known and/or known to the regulator and the regulator has reliable evidence to prove such circumstances, while the second part of this provision refers to the circumstances that simply query (*dovode u sumnju*) e.g. business reputation of the originator, independence of the evaluator, or reputation and independence of the fiduciary representative. In addition, the ILA believe this provision as currently drafted may be considered as a source of legal uncertainty for the securitization transaction participants which should clearly be avoided as much as possible.

6. Servicer

6.1 General

Final Guidelines suggested that the servicing activity should be defined in its scope, however without implying that the SL should go into the actual technical details of performing such activity. In addition, that should qualify as a statutory basis for registration of such business activity in the court register. Namely, it seems the current practice of, at least some of, the court registers is not to allow registration of activities related to collection of receivables, including, but not limited to sending the reminders, encashment of securitized assets and security interest, etc. with argumentation that these activities are basically activities of providing legal services reserved to be rendered by the attorneys at law only. For that reason, the LDT may reconsider introducing the explicit provision differentiating the activities of the servicer from the legal services provided by the legal advisors.

In addition, since the servicers (in particular those not being the banks and/or the originators) would need to register servicing activities as its business activity with the court register, the description i.e. the scope of such servicing activities would need to be included in the SL. Such registration of the servicing activity in the court registry for a specific company would certainly not imply that such company would automatically be authorized to perform such activities without being registered in the securitization registry in accordance with the requirement of the SL.

6.2 Specific issues

Article 18 paragraph 3 of the Draft SL prescribes the requirements legal entity has to meet in order to be able to act as the servicer. One of the requirements is that the relevant person has actually been performing the relevant activities in the period of at least three years prior to execution of the servicing agreement with the

SPV. It is not clear how would the relevant entity prove that it meets this requirement and how should this provision actually be interpreted, i.e. would it be considered that any entity having its customers, sending the invoices thereto, sending them the reminders and starting the enforcement procedures against its defaulting clients would basically satisfy the aforementioned requirement if doing that for its own purposes in the period of at least three years prior to the execution of the servicing agreement with the SPV. It may be useful the LDT to expand the relevant provision by referring to the above remark.

In addition, the Draft SL does not answer to the question whether one servicer could provide this kind of services for the purpose of several securitization transactions.

7. Scope of application of national law

The most important incompliance of the principles incorporated in the Draft SL with the Final Guidelines and the explicit recommendations of the ESF, KfW and the ILA, derives from the fact that the Draft SL does not apply to any aspect of the securitization transactions involving non-Croatian SPV's, even if related to the resident securitized assets. We believe this principle is unacceptable both from the legal and practical perspective and may prove in future to have negative impact to development of securitization transactions in Croatia.

Namely, there does not seem to be any valid reason to treat two securitization transactions both of them involving e.g. (i) resident securitized assets and (ii) other resident securitization participants and investors, differently, merely because one securitization is performed by the non-resident SPV and the other by the resident SPV.

Certainly, in case of a non-resident SPV there would be a number of provisions of Croatian law (including the SL) that would not and should not apply for various reasons, but for a number of issues the SL, i.e. certain provisions thereof, should remain applicable.

By way of example, in case a non-resident SPV would securitize assets owned by Croatian originator (e.g. receivables owed by Croatian debtors) and would on the basis of such resident securitized assets decide to issue and list securities in Croatia in accordance with Croatian law, such securities would be governed solely by the Securities Market Law and not by special provisions of the SL. That would result in situation where (even if the securities and the issuer thereof would meet the requirements prescribed by the SML, which may be difficult in particular with respect to a requirement for the SPV to have financial reports for previous three years), the investors into such securities would be put in a different position (potentially more unfavorable) than the investors buying the securities also issued and listed in Croatia in the course of securitization transaction, but issued by the resident SPV (e.g. in case the foreign SPV would be involved, there would be no obligation for the securitized assets to be evaluated as prescribed by the SL, there would be no fiduciary representative, the investors would not be able to use the

benefit of certain provisions of the SL applicable in case of the originator's bankruptcy or the benefit of the statutory pledge for the benefit of investors, etc.).

In addition, as a consequence of such limited application of the SL, in case described above, any Croatian entity could act as the servicer of the Croatian securitized assets, as the SL would simply not apply to the securitization transactions where the SPV is a non-resident, even if all the other participants would be residents. The same would apply to e.g. the fiduciary representative.

8. Other issues

8.1 General

We understand that certain very important provisions dealing with the scope and procedure of HANFA's supervision of the securitization participants, as well as provisions dealing with liquidation of the securitization funds and the misdemeanors in general, are yet to be drafted and included in the next draft SL. Due to significance and impact those provisions may have to the contemplated structure of the SL, special attention of the LDT should be paid thereto in order for those provisions not to affect the compliance of other existing provisions of the Draft SL with the principles contained in the Final Guidelines (to the extent such principles have been incorporated in the Draft SL).

8.2 Specific issues

Consumers' Protection

In order to be in line with the Final Guidelines, ILA is of opinion that the Draft SL should adequately deal with the obstacle contained in Article 7 of the Consumers' Protection Law. Namely, the said provision prescribes that transfer of the personal data on consumers is prohibited without an explicit prior written approval of the relevant consumer. In order to avoid situation where the originator would have to request its debtors to provide explicit written approvals for transfer of the personal data to the SPV prior to the securitization, it would be extremely facilitating for the securitization transactions if the SL would contain a provision allowing the transfer of the data on consumers without explicit prior written approval thereof for such transfer, based on argumentation that the relevant securitization participants having access to the relevant data due to securitization are bound by the same data and secrecy rules as the originator, and that prohibition of transfer of such data should not actually affect the right to assign the relevant receivable which right to assign is otherwise unrestricted.

a. Table of provisions of the Draft SL that require additional drafting

	ARTICLES/TOPICS
Articles that require some change	3, 6, 9, 11, 13, 14, 16, 17, 20, 21, 23, 25, 26, 28, 29, 31, 32, 33, 35, 41, 43, 53, 55,
Articles that require substantial change	2, 19, 34, 36, 44, 45, 46, 50, 52, 58
Topics that require drafting of additional provisions	Secondary regulation Scope of application of the SL in case of multi jurisdiction elements involved Re-sale of assets Servicing activities; Conditions for other legal persons to act as the servicers Supervision by HANFA Statutory pledge over the securitized assets Derivatives in the context of the securitization Consumers' protection Liquidation of the SPV company Misdemeanors