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# **FINAL GUIDELINES FOR DRAFTING THE CROATIAN SECURITIZATION LAW**

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## **A INTRODUCTION**

Croatian Authorities and market participants acknowledge the benefits of having secure and transparent rules contained in a well-structured comprehensive regulatory framework, to introduce financial and legal practice use of securitization techniques into Croatia.

In order to facilitate the above, the Ministry of Finance has (i) established a Public-Private Steering Committee (hereinafter: the Steering Committee) chaired by Mr Ante Žigman, State Secretary for Finance and consisting of Mr. Zdenko Adrović, Croatian Banking Association, Chairman of the Executive Board, Mr. Davor Holjevac, Vicegovernor of the Croatian National Bank, Mr. Harald Huettnerrauch, Vicepresident for Asset Securitization, KfW, Mr. Irakli Managadze, Senior Policy Advisor, EBRD, Mr. Luigi Passamonti, Head of the World Bank's Convergence Program and Mr. Ante Samodol, President of HANFA, and (ii) established a working group drawn from the private sector and consisting of Mr. Kurt Dittrich, Linklaters, Mr. Bojan Fras, Žurić i partneri and Fabrizio Maimeri, Italian Banking Association (hereinafter: the Legal Solutions Team) to assess the legal and regulatory requirements to undertake securitization transactions on Croatian assets, (iii) obtained an independent legal advice from Porobija & Porobija Law Firm (hereinafter: the Independent Legal Advisors) with respect to the preliminary due diligence performed by the Legal Solutions Team, (iv) discussed and approved the principles for drafting the relevant regulations, on the basis of inputs provided by the Legal Solutions Team and reviewed by the Independent Legal Advisors, (v) mandated the Independent Legal Advisors to prepare this Consultation Document as a basis for International Market Consultations and (vi) appointed the legal drafting team (hereinafter: the Legal Drafting Team) 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, (vii) published the Securitization law Consultative Document and (viii) obtained a feedback from certain market participants with respect to the issues raised in the Consultative Document

## **B PURPOSE OF THESE GUIDELINES**

These Final Guidelines for Steering Committee approval consists of (i) the principles approved by the Steering Committee on its meeting held on August 30, 2006 and (ii) certain principles that are presented here as, among others, a result of the feedback from market participants to the issues raised in the Consultative Document.

On the basis of the Final Guidelines, the Legal Drafting Team should complete drafting the Croatian Securitization Law. It is understood that the Steering Committee will consider such draft law before it is released by the Ministry of Finance for broader consultations by the relevant regulators. Preparation of these Final Guidelines has not benefited from access to work-in-progress by the Legal Drafting Team.

## **C RESIDUAL ISSUES FOR STEERING COMMITTEE CONSIDERATION**

Following is a list of issues to be finally decided by the Steering Committee:

1. Operating of the SPVs as multi-issuance vehicles and using of intermediary SPVs;

2. Definite scope of licensing and supervision of the SPVs;
3. Suitability of the taxes, pension and/or health contributions for securitization;
4. Obligatory rating of the securities issued in the course of securitization transactions and listed in the highest quotation market;
5. Prospectus requirements in case of the securities issued in the course of securitization transactions by way of private placement to institutional investors.

## **D FINAL GUIDELINES**

### **1 STRUCTURE OF THE SECURITIZATION LAW**

The Securitization Law must establish principles without minutely defining the rules. The Law should be detailed to the extent required to maintain conceptual consistency and to implement the necessary rules (the “Golden Middle Approach”).

Securitization Law should define main principles, deal with certain very important issues such as SPV structures, scope of supervision/licensing of SPV and SPV transactions (if any), servicing, taxes, data protection, bankruptcy remoteness to the extent necessary in order to facilitate the securitization transactions, assignment of future receivables, etc. and prescribe that a very limited scope of purely technical issues should be further elaborated by way of secondary regulations. In other words, the Law should take a rather high level principle approach to regulate the abovementioned issues to prevent the framework from becoming inflexible to market innovation. According to the European Securitization Forum (hereinafter: the ESF)<sup>1</sup>, “the Luxembourg Law is generally praised as the best existing example in that regard”.

In order to avoid the proliferation of administrative measures that could generate confusion, in addition to defining the issues subject to secondary regulation, the Law should also, to the extent possible, define/limit the scope of that secondary regulation by defining main principles and the specific issues to be addressed thereby (such as e.g. regulatory capital treatment for financial institutions originators until the Basel II Accord is implemented in Croatia).

Also, as a matter of principle and to the extent possible, all issues to be prescribed should be included in the Securitization Law itself and not in various other laws, i.e. amendments to such laws. Namely, the latter strategy could easily result in discrepancies in wording and interpretation of such different laws, which could lead to further legal uncertainties.

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<sup>1</sup> ESF is a trade association comprised of 160 firms active in the securitization markets across Europe, including commercial and investment banks, investors, trustees, servicers, law firms, insurance companies, rating agencies, auditors, IT service providers and stock exchanges. The goal of the ESF is to promote the efficient growth and continued development of this market throughout Europe, and to advocate the positions, represent the interests, and serve the needs of our members. The ESF also undertakes initiatives designed to educate and inform external constituencies, including legislative and regulatory officials, the financial media, industry participants and others concerning the operation, importance and policy benefits of the securitization market and related activities throughout Europe

**Principle 1.1:** Securitization Law should take a rather high level principle approach to regulate the relevant issues in order to prevent the framework from becoming inflexible to market innovation

**Principle 1.2:** Secondary regulation should be limited in scope and in line with main principles and the specific issues defined by the Securitization Law

## **2 DEFINITION OF SECURITIZATION TRANSACTION**

Securitization Law should provide for a single definition of securitization that would cover securitization structures in which (i) an originator actually transfers a pool of assets that it owns (through a sale/assignment) to an arm's length special purpose vehicle which then issues securities that are based on the underlying (segregated) pool of assets and (ii) an originator retains legal ownership of the segregated pool of assets and transfers only the credit risk associated with an underlying (segregated) pool of assets through the use of credit-linked notes or credit derivatives or by using a sub-participation scheme in which the funds provided to the originator by the SPV by way of a loan would be repaid solely by the proceeds from the segregated pool of assets. The Law should make clear that (a) the sole purpose of the SPV is to acquire pools of assets or risks from such assets and to channel the payments from the underlying assets to investors and (b) segregation would occur at the level of the SPV in the event under (i) above and at the level of the originator in any event under (ii) above.

Definition of securitization should provide for a clear distinction between the securitization transaction, on one hand, and factoring and/or asset sale, on the other hand.

The definition of the securitization should be such as to permit various securitization structures such as asset-backed commercial paper programmes, the master trust securitization schemes, etc., thus allowing structures with replenishment of assets, active pool management and, subject to the approval of the Steering Committee, multi-issuance structures, however without excessive detailed regulation at the law level in order not to discourage market innovations.

**Principle 2.1:** Securitization Law should provide for a definition of the securitization wide enough to cover the synthetic and true sale securitization (including various securitization structures such as sub-participation, asset-backed commercial paper programmes, the master trust securitization schemes, etc.)

## **3 ORIGINATOR**

As the securitization objectives (e.g. regulatory capital relief, financing, improving solvency or ratings, etc.) vary by type of originators, the Securitization Law should not exclude any legal person from being a potential originator of these types of transactions.

**Principle 3.1:** No legal entity should be excluded from being a potential originator of the securitization transactions

## **4 SPECIAL PURPOSE VEHICLE (SPV)**

Securitization Law should provide for a Special Purpose Vehicle organized either as (i) a company or as (ii) a fund structure. Transaction participants should have the flexibility of

choosing an appropriate legal structure for the SPV (between the said two structures) and a choice of the legal form should be neutral as to regulatory, tax, reporting, or any other kind of public intervention criteria.

In case of fund vehicle, this should be a specific Securitization Fund, regulated under Securitization Law to a reasonable extent, with only a few very general provisions of the Investment Funds Law that should apply. Securitization Fund regulation should use the concept of assets without legal personality (managed by the fund management company). Securitization fund management company's activities would have to be limited by reference to the purpose of such fund.

Neither the securitization companies nor securitization fund management companies should be subject to capital adequacy and minimal capital requirements. However, in order to protect investors and other participants against risks/losses arising from additional activities of the securitization companies and/or securitization fund management companies, their corporate objects and powers should also be limited to the activities necessary to effect the securitization transaction.

Activity limits are also important in case of re-sale of the relevant pool of assets. According to the ESF, the re-sale of the pool of assets should be permitted under flexible conditions, as it may become necessary in a particular transaction due to need to (i) replenish the pool of assets with new assets (in case of securitization of revolving receivables), (ii) enable the portfolio managers to re-sell the assets in order to prevent deterioration of the pool of assets or to generate a higher return for investors and thus to generally increase the investors' protection, and/or (iii) enable so-called clean-up calls e.g. in cases where due to the expenses of the transaction, such transaction is no longer viable.

Re-sell proceeds may be used e.g. for a re-investment in new assets and/or repayment to the investors, but should certainly not be managed in an investment fund manner.

Ability of the SPV to enter into hedging arrangements should not be denied, however the Legal drafting team should include a general provision dealing with the main purposes for which the entry into such hedging agreements would be allowed (e.g. for the purpose of ensuring predictability of payments under the issued securities, hedging with the purpose of limiting and/or minimizing various kinds of risks, and similar).

The Law should envisage the possibility of the originator to transfer the assets to a non-Croatian SPV. Non Croatian SPV would of course remain governed by the law of the place of its incorporation on corporate / bankruptcy / tax treatment matters. Please see also under item 11 below.

The SPV company should be able to issue all types of debt securities governed by Croatian law as well as any foreign law (where "foreign law" should clearly mean both (a) the law applicable to the securities *per se*, that is the law determining the form - physical, immobilized or dematerialized - of the securities, their validity and extinction requirements (also known as the issuance law) and (b) the law applicable to the terms and conditions underlying the purchase and repayment of the securities (otherwise known as contract law). The SPV fund would instead be represented by units governed by Croatian law.

Any type of SPV should have an addition to its name in the form of an abbreviation that identifies it as a securitization vehicle. Furthermore, the Law should not limit the use of other vehicles (e.g. trusts) that may become available in the future.

ESF recommended that the incorporation of the securitization SPV should not be subject to prior authorization from a regulator, although such model is followed in some European

jurisdictions. However, the ESF believes that incorporation of the SPV fund's management company could be subject to prior approval from the securities regulator (i.e HANFA), as well as subject to a certain scope of supervision (i.e. approval of the constitutional documents of the management companies, management rules and persons managing those companies). Moreover, ESF is of opinion that establishment of fund and the issue of securitization bonds by the SPV company should, as being a capital market transactions, be subject to otherwise prescribed supervision.

It is our view that, in any way, SPVs and the SPV fund management company should not be subject to extensive regulator's supervision in a way e.g. HANFA supervises investment funds management companies, as the nature of the securitization transactions and in particular activities undertaken by the SPV and/or the SPV fund management company, and consequently the risks associated thereby, differ great deal from the risk attached to e.g. investment funds and their management companies.

Supervision of the SPVs and SPV fund management companies could extend to approval of the management rules, supervision with respect to persons acting as management board members of the management company, ordering of the audits of the fund and the company, reporting for statistical and supervisory purpose, etc.

In addition, the regulator should focus on fulfillment of requirements necessary for issuance of the securities (please see item 6 below) and incorporation of the fund(s), as capital market transaction.

As a conclusion, licensing and supervision procedure should be such as to not impose unreasonable burden and excessive limitations to SPVs and the SPV fund management companies.

The Law should provide for appropriate extension of the competences of HANFA having regard to the reasonable regulatory cost principle. In any event, licensing, limitation of representation of the SPV and supervision, if any, should not cause delays and/or increased costs in structuring and performing the transaction, as otherwise this would certainly lead to international market participants avoiding to use Croatian jurisdictions and Croatian SPVs for securitization transactions and would encourage the development the cross-border transactions.

Definite scope of licensing and supervision of the SPVs is subject to further consideration and decision of HANFA and the Steering Committee.

Connected somewhat to the previous issue, the Securitization Law should also address the issue whether an SPV could be set up for a purpose of a "single-operation" or if a "multi-operations" SPV would also be allowed.

Namely, the Steering Committee was of a view that both the SPV company and the SPV fund should be incorporated for the purpose of a single transaction, and the SPV fund management company should be allowed to incorporate and manage several funds, each fund serving for the purpose of one and only transaction.

It should be noted that the ESF emphasized that in most jurisdictions securitization SPVs are construed as multitransaction vehicles as such structures resulted with many benefits, such as (i) reduction of administrative and audit expenses derived from incorporating and operating SPVs, (ii) maximizing name recognition of the SPVs, and (iii) reducing the time to set up a transaction.

ESF pointed out that a principle of separate compartments is accepted in a number of jurisdictions whereby each compartment operates as a separate entity from the point of view of the securities holders, but all compartments together constitute a unity from the point of view of the SPV management. However, the ESF believes that the statutory pledge principle could also be used to the same effect.

It is our opinion as the independent legal advisors, that the Steering Committee could consider two different options:

(i) introducing in the Securitization Law of the SPV company and SPV fund structure whereby:

(x) the SPV company would be a single operation entity not being subject to licensing and supervision requirements (only the issuance of the debt securities would be subject to the supervision as a capital market transaction); and

(y) the SPV fund management company would be subject to licensing and supervision and also be able to incorporate and operate more than one SPV fund (incorporation of each fund also being subject to the supervision);

or

(ii) envisaging in the Securitization law of the SPV company and SPV fund structure (managed by the SPV fund management company) whereby all those subject would be subject to the licensing and supervision of the regulator, but multi-issuance structures would also be allowed in case of the SPV company.

The Securitization Law should not restrict the existence of structures where several originators would assign their receivables to the same SPV.

The Securitization law should address the definition of the conflict of interests between different parties to the transaction, with the obligation to disclose such potential conflicts in the ABS prospectus.

With respect to the issue whether the securitization structures envisaging intermediary SPV should be allowed by the Securitization Law. The ESF recommends that the Securitization Law should not impose restrictions to using of intermediary SPV. Namely, there may be a number of reasons why a particular transaction would envisage having an SPV for the purchase of underlying 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).

**Principle 4.1:** SPV to be available in the form of a company and a special securitization fund subject to the management of the securitization fund management company

**Principle 4.2:** SPVs should not be subject to capital adequacy and minimal capital requirements, but rather to the prescribed activity limits

**Principle 4.3:** Non-Croatian SPV should also be recognized as parties in securitization transactions

**Principle 4.4:** Regulatory requirements should primarily focus on capital market part of the transaction, i.e. issuance of the securities and incorporation of a fund

**Principle 4.5:** Scope of licensing and supervision of the securitization transactions and the parties thereto should not impose unreasonable burden and excessive limitations to the transaction

## 5 ASSETS

Assets being object of securitization should be described in a way so as to not exclude any asset or pool of assets which can produce a recurring income stream and thus be a suitable candidate for securitization (receivables, real estates, whole business), provided that other laws do not prohibit the transfer of such assets. ESF suggested that any restrictions imposed by any other Croatian law with respect to the assets that could be subject to securitization should be removed by the Securitization Law. Steering Committee should make a final decision whether the ESF suggestion should be accepted and consequently whether the draft Securitization Law should envisage an explicit provision allowing for securitization of e.g. taxes, pension and/or health contributions, etc.

The pool of securitized assets is to be reserved for satisfaction of claims by the owners of the securities or the holders of the units in the fund (i.e. the investors) and the other creditors of the SPV related to costs of the transaction. For this reason, the pool of securitized assets should be segregated from other assets of the SPV.

In case of SPV being a company, separation of the pool of assets should be achieved by statutory pledge over such pool for the benefit of the investors and (to the extent possible) the other creditors of the SPV related to the costs of the transaction (in each case excluding other creditors unrelated to the transaction).

Alternatively, contractual security interest could be created over such pool of assets. In both cases, the security interest could be held by the security trustee. On this alternative, please see, however, item 8 below.

In the case of a SPV incorporated as a fund, non-existence of legal personality of the fund and its separateness from the originator and management company, whereby the management company manages the fund but does not own it, should be sufficient to achieve segregation of the pool of assets.

When addressing the assets being appropriate for securitization, the main requirement should be that the relevant assets must be identified or be capable of being identified at the time the relevant assets come to existence.

In that respect, particular attention should be paid to the issue of future receivables. Draft law should contain a definition of future receivables, as well as provisions providing answers to the questions whether future flows constitute eligible collateral for a securitization and whether the sale of future receivables or future cash flows to the SPV could be enforced, especially following the insolvency of the originator.

Special attention should be paid to the status of the assignment of the future receivables from the perspective of the potential bankruptcy of the originator. It is recommended by the ESF that the approach introduced in the Luxembourg Law is followed in that respect and that consequently the Securitization Law explicitly prescribes that the assignment of future receivables would be effective upon coming into existence, notwithstanding the opening of a bankruptcy procedure or any similar procedure against the originator before the date on which the assigned receivables come into existence.

Under Croatian law, together with the assignment of the receivables, transfer of the collateral being of ancillary legal nature occurs as well. Having in mind the fact that registration thereof usually becomes an issue in case of the enforcement of the security interest or in case of the originator's bankruptcy, as well as the costs and time necessary for the registration, a concept of securitization register should be considered more closely.

Such register may be used for at least two purposes: (i) to achieve isolation of the assigned assets from the legal reach of the originator and its creditors; and (ii) to make public the assignment of the assets with respect to the debtors and other interested parties.

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 (land registry, registry of court and notary public's security interest, etc.) should be further analyzed. In order to analyze more closely the benefits of such registers, additional information and experience on how similar register works in Greece and Germany (refinance register) should be obtained and researched while drafting the Law.

**Principle 5.1:** Securitization law should not exclude any assets otherwise suitable for securitization from being securitized

**Principle 5.2:** Securitization Law should provide for segregation of the securitized assets

**Principle 5.3:** Securitization Law should include special provisions related to the securitization of the future receivables

## **6 SECURITIES**

The Securitization Law should not limit the types of debt securities that may be issued in securitization transactions.

Either special provisions in the Securitization Law or amendments to the Securities' Market Law should recognize issues in different tranches, each such tranche being subject to different terms and conditions. It should also be made explicit that a single prospectus would suffice for a single transaction, regardless of the tranching of the securities.

Provisions of the Securities Market Law regarding the approvals for issuing securities will apply to the securities issued under Croatian law in the course of securitization transaction (both in case of SPV company and fund). However, special provisions in the Securitization Law are necessary in order to adequately deal with specific information characteristic for securitization (e.g. disclosure of potential conflicts of interests between the originator and the SPV; the SPV as issuing entity has no history of financial reports; etc.). In that respect, the stock exchange regulations will also need to be amended in order to address particularities of securitization transactions.

Securities should be subject to high, but reasonable disclosure standards, preferably in line with internationally accepted ones and thus the EU Prospectus Directive should be applied as a guiding principle. It is suggested that in case of a private offer of the securities made only to the institutional investors, there is no obligation to make the prospectus, unless one or more institutional investors subscribe and pay in all the securities of that issue, with the intention of offering them for sale to persons that are not institutional investors within a period shorter than one year. In the later case, the SPV would be obliged to file to HANFA the request for approval of the prospectus before the institutional investor starts offering

securities for sale, and the institutional investor shall be obliged to make such prospectus available to potential customers before the sale.

Participants to each securitization transaction should be able to decide whether or not the ABS should be rated, depending on the target investors. Contrary to the views of certain members of the Steering Committee that the ratings should be obligatory if the intention is to list the securities in the highest quotation market, ESF believes that this should not be the case, as in countries like France or Spain where the law imposed mandatory ratings, such obligation has been strongly contested by market participants. It seems reasonable that the Securitization law does not provide for any special provisions with respect to the ratings applicable to the securities issued under that law, but rather in that respect such securities should remain subject to the general provisions of the Securities Market Law and the relevant stock exchange rules.

On the other hand, it would be advisable that the Securitization law prescribes special provisions imposing different requirements for listing of the securities issued in the securitization structure in the first quotation of the stock exchange comparing to those prescribed by the Securities Market Law (e.g. requirements related to the share capital of the issuer and the publication of the financial reports in at least three business years prior to the listing should not be applicable in the securitization structures, or otherwise the securities issued by the SPV in principle would not be acceptable for listing in the first quotation of the Croatian stock exchange). In that respect, as stated above, the stock exchange regulations will also need to be amended accordingly.

Profit Tax Law provides for a withholding tax on interest payable by Croatian payer to foreign payees. The said Law provides for an exception only with respect to the interest payable on bonds (corporate or state) held by foreign legal entities. Therefore, in order to avoid implicit preference for certain types of ABS, the said exemption should be extended to all types of securities issued under the Securitization Law.

Securities issued or marketed under a foreign law (see also item 5 above) would remain subject to the applicable issuance or contract law on any matters discussed above, such as disclosure, prospectus or rating requirements.

**Principle 6.1:** Securitization Law should provide special provisions dealing with certain issues relevant also in securitization transactions (one issue with several different tranches, disclosure standards, ratings, listing requirements, withholding tax)

## **7      SERVICER**

In any securitized transaction servicing represents an important link between the investors and the debtors and the quality of assets servicing can influence great deal the performance of the assets and on the securities they secure.

Securitization Law should provide a definition, i.e. a scope of servicing activities. Such provision would also be a legal basis for registration with the court register of corporate entities for providing such services.

Entities authorized to render servicing activities should be (i) licensed financial institutions and (ii) originators. The Law should provide that the originator is entitled to carry on all or any part of the servicing activities without being explicitly registered for providing thereof.

The Law should provide for a possibility that some of the activities making part of the servicing activities are rendered by different service providers. It would also be useful for the Law to explicitly prescribe that rendering of any activities making part of the servicing activities would not qualify as providing legal advice. In view of the possible future evolution of the servicing activity, the Law should delegate secondary regulation to add further categories of eligible servicers (other than licensed financial institutions and originators) when appropriate.

Supervision similar to that described for management companies (see item no 5) would be appropriate for the servicers as well. As stated above, it was also recommended by the ESF that the Croatian law should recognize servicers authorized in EU jurisdictions.

Offering circular or other relevant disclosure document should provide for sufficient details about the servicer and the contractual arrangements between the SPV and the servicer.

One of the noteworthy aspects of securitization transactions is certainly a commingling risk, i.e. a risk of not being able to differentiate between the servicer's financial funds arising from the securitization transaction (which funds are actually not servicer's but instead the servicer is obliged to transfer such funds to the SPV) and its other funds.

Securitization Law should provide for provisions being able to adequately mitigate such commingling risk. Relevant provisions should state that (i) any collected proceeds shall be deposited to a separate bank account, (ii) such collected proceeds shall not make part of the servicer's assets or its liquidation/bankruptcy estate, and they may not be subject to enforcement for satisfaction of the servicer's debts, and that (iii) the servicer shall at all times act and dispose with the collected accounts only in accordance with the SPV's instructions. That way the SPV would have a right of separation (*izlučno pravo*) with respect to the collected amounts. To the extent necessary, any detailed regulations in that respect should be developed in the secondary regulations.

In order to enable the servicer by operation of law to enforce a claim and realize the security interest in its name and on behalf of the SPV, appropriate and explicit provisions to that effect should be included in the law.

**Principle 7.1:** Securitization law should prescribe a definition of the servicing activities

**Principle 7.2:** Originator, licensed financial institutions and other categories of eligible servicers (as prescribed by subsequent secondary regulation) should be authorized to render servicing activities

**Principle 7.3:** Securitization Law should provide provisions appropriate to mitigate any commingling risk related to the servicers

## **8 BONDHOLDERS' MEETING/FIDUCIARY REPRESENTATIVE/SECURITY TRUSTEE**

Given that the issuance of ABS is the principal activity of the SPV company, there is arguably a need to give to the ABS holders some control rights over the operations of such SPV. In order to provide such rights to the ABS holders, an organization thereof in a form of a bondholders' meeting and joint - fiduciary – representative, should be envisaged either by the amendments to the Securities Market Law or by the Securitization Law. Such provisions should prescribe at least a minimum scope of the authorities of a bondholders' meeting and a joint - fiduciary – representative, leaving other issues to be defined by the terms and conditions of the ABS.

In case of SPV funds, the Law should prescribe that the SPV fund management company should act in the interest of holders of the fund's units.

In addition, since the Croatian law does not recognize the concept of the security trustee otherwise recognized by common law jurisdictions, where the trustee holds the security interest on behalf of the ABS holders, it is yet to be decided whether the Securitization Law should introduce in Croatian legal system an institution of the security trustee and, if yes, to what extent could the Anglo-Saxon security trustee principles be adequately incorporated in Croatian law. ESF believes that introducing of the new institute such as this one would not be absolutely necessary from the perspective of the Securitization Law, but instead that the broad and flexible provisions of the Securitization Law related to the bondholders representative would suffice the purpose.

As Croatian law does not recognize the concept of the trust and consequently of the security trustee, it is our view as the independent legal advisors that the initiative for ratification of the Hague convention on the law applicable to trusts and on their recognition that entered into force on 1 January 1992 (which is an international private law convention whose ratification does not introduce *per se* the concept of trust in a legal system otherwise not recognizing such concept, but allows the recognition of a trust regulated abroad) and that has been ratified so far by, among others, Italy, France, Luxembourg, the Netherlands, UK, should be considered by the relevant Croatian authorities. In that way it would become possible that a foreign trust is registered in the land registry as the holder of property and/or security interest.

**Principle 8.1:** Securitization law should contain provisions on the bondholders' meeting and joint (fiduciary) representative of the bondholders and their minimum scope of activities, leaving the other relevant issues to be defined by the terms and conditions of the relevant securities. Securitization fund management company should act in the interest of the fund's units.

## **9 TAX TREATMENT**

Certainty should be provided as to what type of taxes are payable by the originator, the SPV and the investors. Since multi-jurisdictional transactions create certain additional tax issues, those should be also considered by the Tax Administration and adequately addressed in the Securitization Law or amendments to the relevant tax laws and regulations.

Among the issues that need to be considered and adequately regulated, are the following: withholding tax, VAT and permanent establishment issue triggered by a securitization transaction in general and as well as by involving a non-Croatian SPV in such transaction. In addition, it should be ensured that no transfer tax are payable on the transfer of the assets or the security to the SPV.

When considering the relevant tax issues, it should be taken into consideration that the securitization transactions are not tax motivated, they do not change the character of the original transaction between the originator and the debtor and they are construed to achieve fiscal transparency and neutrality.

**Principle 9.1:** Securitization law should provide certainty as to the taxation issues arising in the course or as a result of the securitization transaction

## 10 BANKRUPTCY REMOTENESS

Bankruptcy remoteness of the SPV is one of the main requirements for a successful securitization. Therefore, addressing in the Securitization Law various features for achieving the highest possible degree of the “bankruptcy remoteness” of SPV should be one of priorities.

SPV fund should not be made subject to general bankruptcy law by virtue of the Securitization law.

Although the insolvency of the SPV being a company is a rather remote possibility as securitizations are generally structured in a way to make this event very unlikely, the Securitization Law should address specific issues aiming at achieving the bankruptcy remoteness even more.

Bankruptcy of the SPV being a company could not be excluded as a possibility due to the fact that the Croatian Bankruptcy Law would apply thereto without any exception. However, the statutory lien of the ABS holders over the securitized assets, restrictions to be imposed on the SPV with respect to its scope of activities and certain contractual provisions (e.g. limited recourse / no petition clauses, role of bondholders representative, etc.) minimize the need for legislative intervention regarding the bankruptcy of the SPV.

Croatian Law does not explicitly recognize limited recourse and no petition clauses. Having in mind the facts that such clauses are considered to be instruments for achieving bankruptcy remoteness of the SPV and that it is not free from doubts whether the Croatian law would consider such clauses to be valid and enforceable, the Legal Drafting Team should ensure that the validity and effectiveness of such clauses are explicitly acknowledged by the draft Law. In that respect, the Luxembourg securitization law may be a good example as to how to address this issue in the draft Securitization law.

Further bankruptcy remoteness of the SPV, especially in case of the bankruptcy of the originator and/or servicer could be achieved by e.g. 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. In the event of securitization through credit derivatives or sub-participation scheme, bankruptcy remoteness would apply directly at the level of the originator through the exclusion from the bankruptcy estate of the underlying assets and related cash flows as a consequence of the statutory lien provision.

The above envisaged bankruptcy remoteness rules would apply to the relevant Croatian entities (whether originators, servicers, SPVs) as foreign entities would be subject to their applicable foreign bankruptcy law.

**Principle 10.1:** As a matter of priority, the Securitization Law should contain provisions adequate to achieve the maximum possible degree of bankruptcy remoteness of the SPV (including, but not limited to recognition of the limited recourse and no petition clauses, defining requirements for a true-sale characterization of the transactions, etc.)

## 11 SCOPE OF APPLICATION OF NATIONAL LAW

Multi-jurisdictional securitization transactions very often face significant legal barriers and/or legal uncertainties. It could be expected that in a great deal of securitization transactions substantial foreign elements would be present, e.g. foreign SPV acquiring receivables due by domestic debtors, domestic SPV issuing securities abroad, domestic SPV acquiring receivables due by foreign debtors and contracting servicing arrangements with foreign servicer, domestic SPV issuing ABS abroad, etc. Conflict of law issues which may affect validity and/or enforceability of assignment of receivables, as well as legal uncertainty as to which rules of national law apply to which aspects and participants of a securitization structure containing one or more foreign elements (e.g. benefit of provisions related to statutory lien, taxation and bankruptcy remoteness, reporting for statistical and supervisory purpose, etc.), should be addressed in the Securitization Law.

The extent of application of the Law should also be clear in transactions where foreign law would govern the assignment agreement and/or the securities would be issued abroad.

Therefore, it is suggested that a special attention of the Legal Drafting Team is paid to the issue of applicable law in the context of various aspects of such multi-jurisdictional securitization transactions (including, but not limited to those mentioned above). In this respect, some guidelines (without pretending to be exhaustive) are given throughout the document on international private law matters connected with the issuance and marketing of securities, incorporation and bankruptcy of SPV companies and claw back rules.

**Principle 11.1:** Securitization Law should provide for a clear scope of its application in transactions containing one or more foreign elements

## 12 DATA AND CONSUMERS' PROTECTION RULES

Having in mind the existing provisions of Croatian law dealing with secrecy and data protection, in particular the Personal Data Protection Law and the Consumers' Protection Law, that would cause substantial problems to the securitization procedure, it is necessary that the Securitization Law address these issues in an adequate way.

Since the data and consumers' protection are particularly sensitive issues deserving considerable attention in the consulting and the drafting stage, it shall be of the essence for drafting the relevant provisions in the Securitization Law that the representatives of Data Protection Agency and Consumers' Protection authorities are deeply engaged in the forthcoming consultations and drafting.

As a matter of principle, the rights of the debtors of the sold receivables must be preserved and their legal position/rights must not change after a securitization is implemented. Decision whether or not, and if yes when, the originator and/or the SPV would inform the debtors of the sale and assignment should remain with the transaction participants. The Securitization Law should provide for a possibility of joint notification of debtors by means of e.g. public announcement in the Official Gazette and/or in the daily press. In order to facilitate the use of such notification and to avoid any legal uncertainty resulting therefrom, an explicit provision on legal consequences of such notification (i.e. legal consequences thereof should be the same as in case of notification sent to each debtor directly and separately) should be incorporated in the Securitization Law. Again, the data and consumers' protection issues would have to be adequately addressed in this context as well.

Principles of the EU data protection regulations and practice should be used as the guiding principles when addressing the data protection issues. In particular, special attention should be paid to the German coding model as specified in Circular 4/97 of the German Financial Supervisory Authority and/or Italian model as specified in *Garante per la Protezione dei dati personali* Newsletter 2-8 April 2001.

ESF recommends the simplest and the least costly way to deal with secrecy (including banking secrecy), data and consumers' protection issues and that is to include in the Securitization Law an explicit provision stating that the transfer of necessary personal data to the relevant transaction participants (e.g. servicer, rating agencies, advisors) would be allowed as such participants would be bound by the same secrecy and data protection obligations as the originator.

**Principle 12.1:** Rights of the debtors of the sold receivables must be preserved and their legal position/rights must not change after a securitization is implemented

**Principle 12.2:** The Securitization Law should provide for a possibility of joint notification of debtors by means of e.g. public announcement in the Official Gazette and/or in the daily press

**Principle 12.3:** The Securitization Law should implement principles of the EU data protection regulations and practice

### 13 RECHARACTERIZATION RISK

Recharacterization risk is one of the risks related to the securitization transactions.

Mitigation of such risk would adequately be achieved by (i) introducing into the draft Securitization law of a definition of the true sale securitization and of a provision stating that characterization thereof for accounting, tax or regulatory reporting purposes would not have impact to legal characterization of the true sale transactions and (ii) dealing with bankruptcy remoteness as mentioned herein.

**Principle 13.1:** The Securitization Law should provide provisions adequate to mitigate recharacterization risk

### 14 OTHER ISSUES

Securitization Law should not specifically address the issues like: statutory limits on costs of securitization transaction, handling and allocating of the surplus cash flow received by the debtors of the assigned receivables, a risk of SPV that the originator could in the future set the interest rate at the level not sufficient to cover SPV's costs (in cases where a variable interest rate is not linked to some benchmark rate (e.g. ZIBOR, EURIBOR), but is set according to interest rate policy of the originator (lender)) and the content of contracts of securitization transactions.

Having in mind the costs of securitization transactions, which are always substantial due to a complexity of the relevant structures, as well as other resources necessary for such transactions it is highly unlikely that the size of this kind of transactions would be small. Therefore, it does not seem reasonable to impose any statutory minimum size of transactions.