Republic of Croatia
Ministry of Finance

Croatian Securitization Law
Consultative Document

International Market Consultations
4-24 October, 2006

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Ministry of Finance would be grateful for any comments to be sent by 24 October 2006 to the following address:

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A INTRODUCTION

Croatian Authorities acknowledge the benefits of having secure and transparent rules contained in a well-structured comprehensive regulatory framework, with a view to enhance legal certainty and transparency of the securitization transactions, thus introducing into Croatian financial and legal practice use of securitization techniques.

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 Huettenrauch, 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) sought the advice from a working group, sponsored by the Croatian Banking Association and coordinated by local financial advisory firm Arhivanalitika d.o.o., 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 from the Ministry of Finance, the Croatian National Bank, the Croatian Agency for Supervision of Financial Services and the Croatian Banking Association.

B DRAFT GUIDELINES FOR DRAFTING CROATIAN SECURITIZATION LAW

This Consultation Document, prepared by the Independent Legal Advisor and approved by the Steering Committee, sets out the most important parts of the Draft Guidelines representing the principles approved by the Steering Committee and the Steering Committee's early views on how certain issues should be addressed in the draft Croatian Securitization Law.

The Independent Legal Advisor will finalize the Draft Guidelines after analyzing responses received in the course of the consultation process. This phase is expected to be completed by November 3, 2006.

On the basis of the Final Guidelines, as approved by the Steering Committee, the Legal Drafting Team will start drafting the proposed Securitization Law. The Steering Committee is scheduled to consider the proposed draft Law on November 30, 2006.

Following this meeting, and depending on its outcome, the Ministry of Finance will start the official process to prepare the draft Law.

C RESPONSES TO CONSULTATION

We invite you to comment on the Draft Guidelines and on the questions we have included herein. Please provide us with any additional information to support any comments, issues or arguments raised. Please kindly provide also details of any organization whose views you represent.

D DRAFT GUIDELINES

1 STRUCTURE OF THE SECURITIZATION LAW

The Securitization Law would establish principles and be detailed to the extent required to maintain conceptual consistency and to implement the necessary rules (the "Golden Middle Approach").

Securitization Law would define main principles, deal with certain very important issues such as SPV structures, scope of supervision/licensing of SPV and SPV transactions, 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 would be further elaborated by way of secondary regulations. It is expected that the Law would also, to the extent possible, define/limit the scope of that regulation by defining main principles and the specific issues to be addressed thereby.

Q1: Do you find the above approach advisable?
Do you suggest any other broad principle to inform the drafting of the Law?
Is there any particular example of EU Law that you would suggest to be used as reference?
Please provide examples of the securitization issues usually addressed in the secondary regulations.

2 DEFINITION OF SECURITIZATION TRANSACTION

Securitization Law would provide for a definition of securitization that would include both (i) traditional securitization, i.e. one in which an originator transfers a pool of assets that it owns to an arm's length special purpose vehicle which then issues securities that are based on the underlying pool of assets and (ii) synthetic securitizations, i.e. one in which an originator transfers only the credit risk associated with an underlying pool of assets through the use of credit-linked notes or credit derivatives while retaining legal ownership of the pool of assets.

Q2: What are your views on addressing both definitions in a single law?
If you agree with this approach, are there any aspects that would require particular care?
If you do not agree with this approach, how would you suggest these two types of the securitization should be addressed in the law?

What are your views on approach to include special provisions dealing with asset-backed commercial paper programmes, master trust securitization schemes and sub-participation in the Securitization Law?
In your opinion, would the Securitization Law be the proper place to regulate the covered bonds?
What particular issues should be addressed in the Law with respect to the covered bonds?

3 ASSETS

Assets being object of securitization would 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.

Q3: Do you think any other type of assets should be included in the definition of the assets suitable for the securitization?

The pool of securitized assets would be separated from other assets of the SPV, for satisfaction of claims by the owners of the securities, i.e. the investors and, to the extent possible, the other creditors of the SPV related to the transaction.

In case of SPV being a company, separation of the pool of assets would 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 transaction (in each case excluding other creditors not related to the transaction).

Q4: What are your views on the statutory pledge approach?
Do you think the contractual security interest over such assets would be a better solution?

In the case of a fund SPV, separate legal personalities of the fund and the management company would be used to achieve separation.

Q5: Do you agree that separate legal personalities of the fund and the management company would be sufficient to achieve separation of the pool of assets?
If not, what would, in your opinion, be a better solution?

It is proposed that a Securitization law would contain a definition of future receivables, as well as provisions dealing with future flows as eligible collateral for a securitization and ability of enforcement of the sale of future receivables and/or future cash flows to the SPV, especially following the insolvency of the originator.

Q6: In your experience, are future flows usually considered as eligible for securitization in other jurisdictions?

If yes, how are they usually identified in the assignment agreement and any related security agreement?
What is usually the status of the assignment of future flows following insolvency of the originator in other jurisdictions?
Please describe which kind of receivables are usually considered as future receivables, i.e. does future contracted receivables usually fall into this category?
What is usually the status of the assignment of future uncontracted receivables following insolvency of the originator in other jurisdictions?

Steering Committee proposes a concept of securitization register to be considered more closely, with an aim to use such a register at least in order to (i) achieve isolation of the assigned assets from the legal reach of the originator and its creditors; and (ii) make public the assignment of the assets with respect to the debtors and other interested parties. Achieving the registration of the transfer 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.) may be further analyzed.

Q7: Please provide information on your experience with similar kind of registry existing in Germany, Greece or elsewhere.
Are there any additional benefits and/or reasons why we should consider including provisions on this kind of registry in the Croatian Securitization Law?

4 ORIGINATOR

In principle, the Securitization law would not exclude any potential originator from taking benefit from this type of transactions. However, a treatment of physical persons as originators is still to be further considered.

Q8: What are your views on approach to exclude a possibility of physical persons acting as originators?

5 SPECIAL PURPOSE VEHICLE (SPV)

It is proposed that the Securitization Law would provide for (i) a company and (ii) a fund structure. Transaction participants would have the flexibility of choosing an appropriate legal structure for the SPV (between the said two structures) and a choice of the legal form would be neutral as to regulatory, tax, reporting, or any other kind of public intervention criteria.

In case of Fund vehicle, this would be specific securitization fund, extensively regulated under Securitization Law, with only a few very general provisions of the Investment Funds Law that would apply. Securitization fund regulation would use the concept of assets without legal personality (managed by the fund management company).

Q9: What is your opinion on the above approach of using both company and fund structure?
Are there any advantages of using only one of these two structures?
What difficulties could face the market participants if only one of these structures would be envisaged by the Law?
In case only one type of vehicle would be used, in your experience, which type would be more acceptable to the market participants?

It is proposed that neither the securitization companies nor securitization fund management companies would 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 SPV company and/or SPV fund management company, their objects and powers would be restricted as closely as possible to the activities necessary to effect the securitization transaction. Activity limits seems to be important in case of re-sell of the relevant pool of assets. Should the re-sell be permitted under specific conditions, re-sell proceeds should certainly not be managed in an investment fund manner.

Q10: Please provide examples of activities and/or contractual relationships that would be absolutely necessary for the SPV to effect the securitization transaction.
Are there any reasons why we should consider allowing the re-sell of the SPV's pool of assets?
What would usually happen with the proceeds of the re-sell and the SPV following the re-sell?

It remains to be answered whether any limits and, if yes, what limits should be placed on the ability of the SPV to enter into hedging arrangements. Details related to this kind of issues may be prescribed by secondary regulation.

Q11: Please provide details of types of hedging arrangements that would be absolutely necessary to be allowed to SPV, if any?

The Law would envisage the possibility of sale of Croatian receivables to a non-Croatian SPV and it is proposed that the Law also prescribe to what aspects of the transaction the Croatian Securitization Law would be applicable in case a non-Croatian SPV would be included, and/or if foreign law would govern the assignment agreement and/or the securities would be issued abroad.

Q12: Please provide examples of conflict of laws issues market participants usually face in multi-jurisdictional securitization transactions.

It is proposed that the licensing procedure would be such as to not impose unreasonable burden and excessive limitations to SPVs and management companies, and would basically include approval of the constitutional documents and prospectus of the SPV fund,

constitutional documents of the management companies and SPV companies and approval of representation of the same entities.

In addition, it is proposed that a supervision of the SPVs and SPV fund management companies would extend to, including but not limited to, an 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.

Definite scope of licensing and supervision of the SPVs is subject to further consideration of HANFA, the Steering Committee and the outcome of the consultation process.

Q13: What are your views on the above proposed approach related to the scope of licensing and supervision of SPV?
What is perceived by the market participants to be acceptable level of licensing requirements and scope of supervision?

It is proposed that both the SPV in the form of a company and the SPV formed as a fund would be incorporated for the purpose of a single transaction, but the SPV fund management company would be allowed to incorporate and manage several funds, each fund serving for the purpose of one and only transaction.

Q14: Are there any particular advantages of allowing multi-transactions SPV?
How is this issue addressed in other EU jurisdictions?

It has not yet been decided whether the securitization structures envisaging intermediary SPV should be allowed by the Securitization Law.

Q15: What could be the benefits for the market participants if the securitization structures envisaging intermediary SPV would be allowed by the Securitization Law?
Please provide information in which cases such intermediary SPVs are usually used and for which purposes?

6 SECURITIES

The Securitization Law would not limit the types of securities that may be issued in securitizations.

Notwithstanding the structure, SPV would be able to issue all types of debt securities governed by Croatian law as well as any foreign law.

It is proposed that either special provisions in the Securitization Law or amendments to the Securities' Market Law would recognize issues in different tranches, without a need of separate prospectus for separate tranches of the same issue.

Q16: Does the latter represent a common practice in other EU jurisdictions?

Securities would be subject to high, but reasonable disclosure standards, in line with internationally accepted ones and thus the EU Prospectus Directive would be applied as a guiding principle. As an exception, the issuance of the prospectus would be obligatory both in case of public and private placements.

Q17: In your opinion, is the latter a reasonable requirement?

Participants to each securitization transaction would be able to decide whether or not the securities should be rated, depending on the target investors. However, the ratings would be obligatory if the intention would be to list the securities in the highest quotation of a Croatian stock exchange.

Q18: What are your views on the above proposed approach related to the rating of the securities?

7 SERVICER

Securitization Law would 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.

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

Q19: What are your views on the above proposed approach to allow rendering of servicing activities only to the licensed financial institutions and the originators?

It is acknowledged that one of the noteworthy aspects of securitization transactions is 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 would provide for provisions being able to adequately mitigate such commingling risk. It is proposed the relevant provisions to 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 segregation right (*izlučno pravo*) with respect to the collected amounts.

Q20: In your view, would the principles described above be sufficient to adequately mitigate the commingling risk? Are there any additional ways to mitigate such risk that proved to be efficient in the practice?

Solution is yet to be found as to how to address in the Securitization Law a relation between the servicer's right to enforce a claim and realize the security interest, on one hand, and the fact that it does not have title to the receivable and the related security interes, on the other hand.

Q21: Please provide information in which capacity the servicer usually enforces the assigned receivables and related security interest?

8 BONDHOLDERS' MEETING/FIDUCIARY REPRESENTATIVE/SECURITY TRUSTEE

Given that the issuance of ABS is the principle activity of the SPV, there is arguably a need to give to the ABS holders some control rights over the operations of the 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, would be envisaged either by the amendments to the Securities Market Law or by the Securitization Law.

Q22: Would there be any practical difficulties if the law would prescribe a minimal scope of authorities of a bondholders' meeting and a joint fiduciary representative of the bondholders?
Is this usual in other EU jurisdictions?

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 a civil law system like Croatian.

Q23: What are your views on (i) introducing in the Securitization Law of the security trustee concept in line with common law jurisdictions and (ii) potential difficulties arising from incorporation thereof in civil law system?

9 TAX TREATMENT

Steering Committee understands that comfort should be provided with respect to tax neutrality of securitization transactions and as to what type of taxes are payable by the SPV and ABS investors.

Q24: Please provide examples of how taxation issues are usually addressed in other jurisdictions, i.e. by introducing special provisions in the relevant laws or by obtaining tax administration guidelines or in any other way

Among the issues that need to be considered and definitely opined by the Tax Authority, are the following: withholding tax, VAT and permanent establishment issue triggered by a securitization transaction involving a non-Croatian SPV. When considering the relevant tax issues, it would be taken into consideration that the securitization transaction should not change the character of the original transaction between the originator and the debtor.

Q25: Please provide information on what additional tax problems market participants usually face in the context of the securitization transactions.

10 BANKRUPTCY REMOTENESS

Steering Committee acknowledges that the bankruptcy remoteness of the SPV is one of the main requirements for a successful securitization and that addressing various features for achieving the highest possible degree of the "bankruptcy remoteness" of SPV should be one of priorities.

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 for bondholders representative, etc.) would minimize the need for legislative intervention regarding the bankruptcy of the SPV.

Q26: Would you agree with the above approach with respect to instruments for minimizing the risk of bankruptcy of the SPV? What other instruments would you suggest for achieving that purpose?

Croatian Law does not explicitly recognize limited recourse and no petition clauses. Having in mind the fact 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, it is proposed that validity and effectiveness of such clauses would be explicitly acknowledged by the Law.

Q27: How is this issues addressed in other EU jurisdictions?

In addition, the Securitization Law would also recognize and give effect to subordination contractual arrangements between the SPV and its creditors and between the group of creditors concerning the extent of their rights in respect of the SPV's assets.

Q28: Is this approach common in other EU jurisdictions?

It is proposed that 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), 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.

Q29: What are your views on the above approach related to achieving bankruptcy remoteness?
What other instruments of achieving bankruptcy remoteness of the SPV would you suggest to be included in the Securitization Law?

11 SCOPE OF APPLICATION OF NATIONAL LAW

It is proposed that 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, would be addressed in the Securitization Law.

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 absolutely necessary that the Securitization Law address these issues in an adequate way.

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. It is proposed that the Securitization Law would 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.

Q31: Are there any other notification instruments used in EU jurisdictions that, in your opinion, would be more efficient?

Principles of the EU data protection regulations and practice would be used as the guiding principles when addressing the data protection issues. In particular, it is proposed that 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.

Q32: What are your views on the above approach related to the data and consumers' protection rules? What other instruments of dealing with those issues would you propose to be included in the Securitization Law?

13 RECHARACTERIZATION RISK

It is proposed that the Securitization Law would attempt to address a risk that a particular securitization transaction would not be recognized as a true sale, but rather be interpreted as a loan granted to the originator by the SPV and secured by the receivables.
Introducing into the draft Securitization Law of a definition of the true sale securitization and 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 may be further considered.

Q34: What are your views on the above approach related to addressing the recharacterization risk in the Securitization Law?
Has this been done successfully in any EU jurisdiction?
What would be the best way to address that risk in the Law?
What other instruments of dealing with those issues would you propose to be included in the Securitization Law?

14 OTHER ISSUES

It is proposed that the 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.

Q35: What are your views on the approach not to address the abovementioned issues in the Securitization Law?