Legal foundations for securitisation transactions and their practical application

Pende, Raul

UNIVERSITY OF ZAGREB
FACULTY OF LAW

RAUL PENDE

LEGAL FOUNDATIONS FOR SECURITISATION TRANSACTIONS AND THEIR PRACTICAL APPLICATION

Master's Thesis

Assoc. Prof. Tomislav Jakšić, PhD
Mentor

Zagreb
August 2023

Acknowledgments

I wish to thank all Friends and Family who were my greatest supporters on this journey.

My eternal gratitude belongs to those Faculty members who “went the extra mile”, especially this last academic year, making my studies memorable and worth looking back to. The latter words of gratitude extend equally to those persons who, during these years, brought the *aspera* portion to the *Per aspera ad astra* proverb, for character is built through hardship.

Finally, I would like to pay special homage by quoting a proverb that accompanies me through life with its wisdom and humour.

מענטש טראכט און גאט לאכט

(Mentsch tracht un Got lacht)

Declaration of Authenticity

I, Raul Pende, under full moral, civil and criminal liability, herewith declare that I am the exclusive author of the master's thesis and that no unauthorised use of any part of other works (use without proper citation) was made and that I did not use any sources other than those listed herein.

In Zagreb on August 31st, 2023

Raul Pende

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1. Introduction

Individuals and companies participating in the market economy have at the base of their operations an asset portfolio whose elements have various levels of liquidity. By liquidity one understands the level of exchangeability of an asset on the market. Cash money is the epitome of liquidity, since universally exchangeable, and allows market participants to engage their capital with the aim to profit.[1] In that context assets like securities (shares, bonds), receivables, real estate, or commodities have lower liquidity, since not universally exchangeable, but have a potential to be mobilised and thus become more liquid. Corporations play a key role in the market economy due to the sheer volume of their capital, and the qualities the legal system bestows upon them. On the other hand, individuals and other companies are of lesser significance when discussing the flow of capital at the highest levels. In their endeavour to raise capital, corporations have various methods of doing so, mainly by issuing shares, taking up loans, selling off assets, or by engaging in complex and structured financing operations. Securitisation is one such complex and structured financing operation aimed at capitalisation.

As the root of the term implicitly reveals, "securitisation" consists in an operation which allows for the mobilisation of immobilised or future assets by means of issuing securities whose principal and yield are bound to the cash flow produced by the engagement of said mobilised assets.[2] Unlike a mere sale of an asset, securitisation activates the value associated with the asset while not explicitly disposing of it.[3] Funding is the dominant consideration for securitisation, while other common drivers include regulatory capital relief linked to credit risk, arbitrage, and balance sheet considerations.[4] Since securitisation is a primarily Anglo-Saxon (common law) operation, the English term is universally used and for the most part interchangeable.[5] Other legal systems use different terms which analogously transmit the meaning of the operation, hence the term *cartolarizzazione* is used in Italy, *titrisation* in French

[1] Inzitari, B. (1983) Trattato di diritto commerciale e di diritto pubblico dell'economia, Volume VI, La moneta, CEDAM, Padova., pp. 24-68.
[2] Pizzutilo, F. (2002) Aspetti finanziari delle operazioni di securitisation, Milano, Giuffrè editore, pp. 2-4.
[3] While inherently correct, the owner of the asset will formally dispose of the asset (remove it from their balance sheet) in order to facilitate the operation but from an economic standpoint will retain its value, the details of which are laid out below.
[4] De Vries Robbé, J.J. (2008) Securitization Law and Practice, Alphen aan der Rijn, Kluwer Law International, pp. 3-5.
[5] Carota, L. (2016) Le operazioni di finanziamento, 6.1. La cartolarizzazione di crediti, Torino, Zanichelli editore, p. 892.

speaking systems, *Verbriefung* in German speaking systems, and *titulización* in Spanish speaking systems.

This thesis offers a comprehensive overview of the legal framework for securitisations in the EU in general, and specifically in Croatia and Luxembourg. Finally, the civil and company law foundations for securitisation transactions will be explored based on the analysis of a true sale securitisation through its key stages.

2. Securitisation structures

At the outset of a securitisation operation the securitisation subject must identify the object of the operation (also known as Asset selection). In this phase a typically homogenous pool of assets is designated for mobilisation. The list of asset types which are being securitised is constantly expanding, yet residential mortgage loans, commercial mortgage receivables, credit card receivables, car loans, trade receivables and consumer loans are the most dominant. [6] It is not as far a stretch to claim that any form of transferrable title that generates future cash flow may be securitised. The subject which holds the designated assets is referred to as Originator.[7] The next step is to legally separate these assets, or merely the associated risk, from the Originator's estate by transferring them to a separate legal entity called Special purpose entity (SPE) or vehicle (SPV), which will assure that these assets serve the purpose of the transaction.[8] In order to fulfil the latter, the SPE will issue and offer securities to Investors, which in turn will be backed by the underlying asset.[9] Securitisation transactions can be divided into three fundamental types: true-sale securitisation, synthetic securitisation, and whole business securitisation.[10]

(a) True-sale securitisation

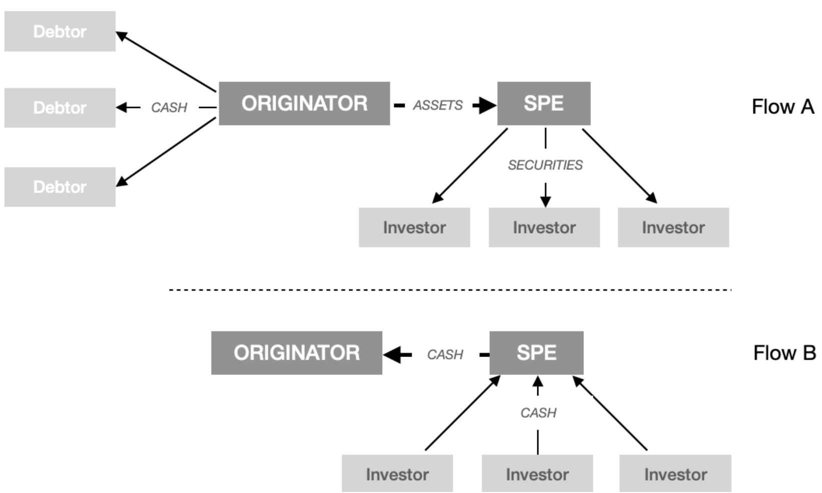
Receivables, which are active assets transferrable by cession[11], are the most commonly used assets in true-sale securitisations thus all further analysis will be based on the securitisation of receivables.[12] These are most commonly generated by mortgage loan agreements where there are two sets of obligations: the creditor's obligation to pay out the sum of the loan to the debtor,

[6] International Finance Corporation (2004), Securitization - Key Legal and Regulatory Issues, p. 2.
[7] Carota, L. (2016), p. 901.
[8] *Op. cit.,* p. 904.
[9] De Vries Robbé, J.J. (2008), p. 15.
[10] *Op. cit.*, p. 5
[11] Carota, L. (2016), p. 895.
[12] De Vries Robbé, J.J. (2008), p. 6.

and the debtor's obligation to pay the loan back in predetermined instalments.[13] The debtor's obligation is the creditor's receivable, and as a future cash flow transferrable by cession may be activated by securitisation. In true-sale securitisation, the term "true-sale" refers to the definitive nature of the cession of receivables occurring between the Originator and SPE ensuring absolute severance from the legal and economical fate of the Originator (also known as Bankruptcy remoteness). The SPE now holds the titles to the loan receivables and can proceed with the emission of securities while the Originators holds a receivable towards the SPE to the amount of the purchase agreement (Figure 1, Flow A).

Since mortgage loans have an average duration of about 20 years[14], these types of long-term positions require an adequate debt security such as asset backed and privately issued bonds, typically by the SPE. Bonds are transferable financial instruments whose embedded right entitles their holder to request the payment of a fixed or floating yield determined by a prospectus, from the bond's issuer.[15] The average maturity of an investment grade bond is 13 years which coincides with the lifetime of a mortgage loan.[16] Once the bonds are allocated to the investors their purchase price is used to settle the Originator's receivable thus fulfilling their goal of mobilising illiquid assets (Figure 1, Flow B).

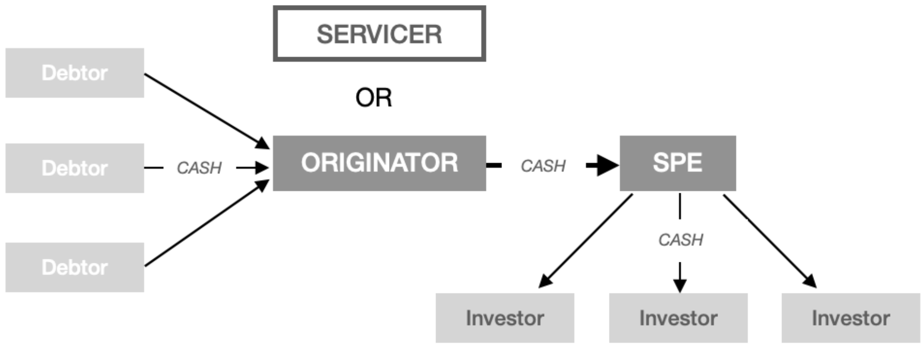
Figure 1: Schematic representation of the asset / cash flows in the stage of securitisation



[13] In civil law systems these agreements are called *synallagmatic* contracts, meaning contracts in which each party is bound to provide something to the other party. For a deeper understanding of other types of contracts see: Klarić, P., Vedriš M. (2014) Građansko pravo, Narodne novine, Zagreb and Torrente, A., Schlesinger, P. (2021) Manuale di diritto privato, Giuffrè Francis Lefebvre, Milano.
[14] Richard J. Kish (2022) The Dominance of the U.S. 30-Year Fixed Rate Residential Mortgage, Journal of Real Estate Practice and Education, 24:1, pp. 1-16. https://doi.org/10.1080/15214842.2020.1757357
[15] Miladin, P. (2013) Pravni odnosi između društva izdavatelja, emisijskog konzorcija i ulagatelja (emisijski posao), Prilagodba hrvatskog prava i ekonomije europskom tržištu kapitala, Pravni fakultet u Zagrebu, Zagreb, pp. 133-178.
[16] Çelik, S., G. Demirtaş and M. Isaksson (2020) Corporate Bond Market Trends, Emerging Risks and Monetary Policy, OECD Capital Market Series, Paris, p. 6.

In the following stage the debtors continue paying their mortgage loan instalments which in turn constitutes the yield payable to the bond investors. Even though they do not hold the original titles, and are thus not the direct creditors, either the Originator or a third-party Servicer will continue servicing these payments for the holder of the receivables and forward the payments to the SPE.[17]

Figure 2: Schematic representation of the cash flow in the stage of servicing



(b) Synthetic securitisation

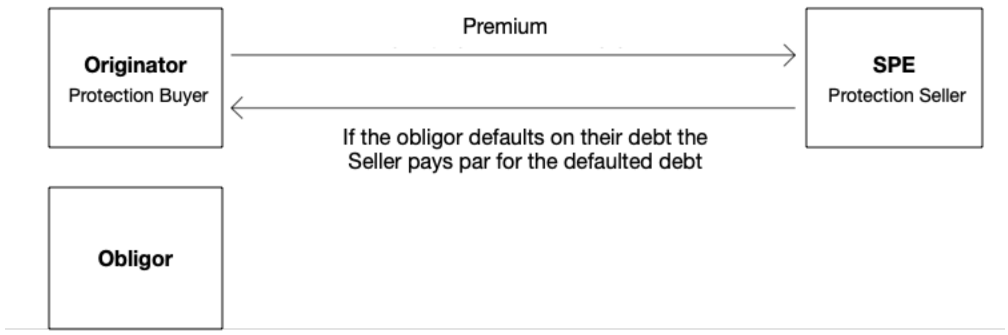
Unlike the sale and transfer of legal titles, synthetic securitisation is a contractual arrangement between the Originator and the SPE aimed at transferring the credit risk related to a portfolio of assets to the final Investors.[18] This transaction may take various forms of funded and unfunded credit derivatives such as credit default swaps (CDS), credit-linked note (CLN) or total return swaps (TRS).[19] In synthetic securitisation the Protection Buyer (Originator) enters into one single or multiple credit default swaps with the Protection Seller (SPE).[20] The Protection Seller will indemnify the Protection Buyer in the event of default or similar adverse event regarding the underlying portfolio.[21] In return the Protection Buyer is obligated to pay a premium to the Protection seller either quarterly or yearly during the lifespan of the CDS.[22] Thus resulting in the transfer of the default risk from the Protection Buyer to the Protection Seller. Credit derivatives generally share many similarities with traditional insurance products.

[17] Deloitte (2018) Securitisation - Structured finance solutions, pp. 19-20.
[18] Baker McKenzie (2022) A Global Guide to Legal Issues in Securitisation, p. 4.
[19] Bomfim, A. N. (2005) Understanding Credit Derivatives and Related Instruments, San Diego (CA), Elsevier Academic Press, pp. 67-90 and 123-126.
[20] Deloitte (2018), p. 14.
[21] *Idem.*
[22] *Idem.*

Unfunded credit derivatives are such agreements where no payment occurs in the instance of perfection, while the payment's maturity is bound to the onset of a certain event.[23] For instance, the Protection Seller will make a payment to the Protection Buyer only when the latter experiences a loss due to the defaults of the debtor.[24] In this constellation the Protection Buyer is exposed to credit risk and relies upon the Protection Seller's ability to fulfil their obligation. Two types of unfunded credit derivatives are CDSs and TRSs.[25]

Credit default swaps (CDS) represent credit derivatives that are activated upon the occurrence of a default event by the reference entity.[26] Within the realm of synthetic securitisation, the reference entity comprises the obligors of the protection buyer. Default events anticipated by CDS agreements commonly encompass bankruptcy, non-payment, debt moratorium, debt repudiation, debt restructuring, and acceleration or default.[27]

Figure 3: Schematic representation of a CDS transaction

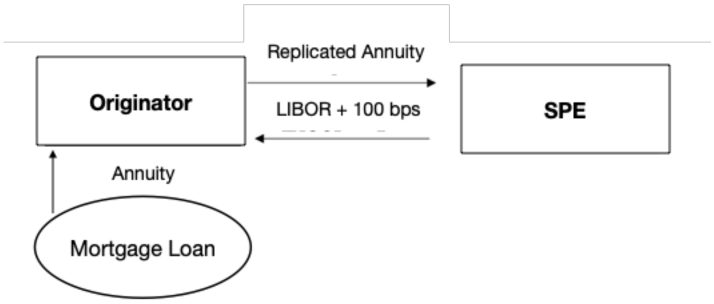


Total return swaps (TRS) are derivative contracts wherein the Total Return Receiver (SPE) receives all the associated cash flows pertaining to a specific reference asset, without engaging in the direct acquisition of said asset.[28] The payments are facilitated by the Total Return Payer (Originator) who replicates the cash flow of the reference asset.[29] In the context of a synthetic securitisation, the TRS agreement between the originator and SPE revolves around the performance of the securitized asset, such as a mortgage loan.[30] Upon the termination of the TRS, assuming the absence of any default by the reference asset, the SPE is remunerated with

[23] Carter, J. and Watson, R. (2006) Asset Securitisation and Synthetic Structures - Innovations in the European Credit Markets, 2nd edition, London, Euromoney Institutional Investor, pp. 47-50.
[24] Bomfim, A.N. (2005), p. 35.
[25] Carter, J. and Watson, R. (2006), pp. 47-50.
[26] Bomfim, A.N. (2005), pp. 67-70.
[27] Fabozzi, F. J. and Kothari, V. (2008) Introduction to Securitization, Hoboken, John Wiley & Sons, p. 321.
[28] Bomfim, A.N. (2005), pp. 83-87.
[29] *Idem.*
[30] Fabozzi, F. J. and Kothari, V. (2008), p. 322.

the final instalment of the loan, alongside the disparity between the market value of the loan at the inception of the TRS and its market value at the maturity of the TRS. [31] The TRS not only emulates the annuity stream of the loan but also incorporates the capital gain or loss that an investor would experience if they had essentially acquired the mortgage loan at the commencement of the TRS and sold it at the maturity date. [32] In the event of the obligor defaulting, the SPE assumes the loss arising from the default, and typically, the TRS will be terminated upon the occurrence of such an event. [33]

Figure 4: Schematic representation of a TRS transaction[34]

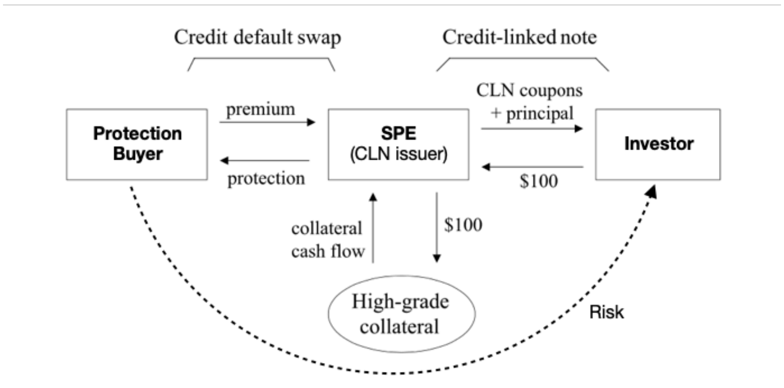


Credit-linked notes (CLN) are credit derivatives that possess inherent characteristics of securities, endowing them with a dual nature. [35] Primarily, CLNs can be freely traded within the open market and ensure the repayment of the principal amount upon maturity. [36] However, they can also be perceived as derivatives of derivatives due to their cash flow being contingent upon an underlying derivative contract. [37] Unlike credit default swaps (CDSs), CLNs do not bear the previously elucidated counterparty credit risk, as the payment is executed upon the perfection of the contract.[38] The face value of these CLNs is typically determined as the disparity between the sub-par amount at which the CDSs were sold and their nominal value, while the proceeds obtained from such sales are either used as collateral or reinvested. [39] There is a cunning similarity between the financial reasoning behind CLNs and factoring transactions, the difference being that the first is a security while the latter is a contractual obligation. The

[31] Bomfim, A.N. (2005), pp. 83-87.
[32] *Idem.*
[33] *Idem.*
[34] *Op. cit.*, p. 84.
[35] *Op. cit.*, pp. 123-126.
[36] *Idem.*
[37] Fabozzi, F. J. and Kothari, V. (2008), p. 323.
[38] *Idem.*
[39] Bomfim, A.N. (2005), pp. 123-126.

returns generated by the special purpose entity (SPE) may either be returned to the protection buyer or distributed to the investors, depending on the terms of the agreement.[40]

Figure 5: Schematic representation of a CLN transaction with an underlying CDS [41]



In summary, the described arrangement involves an investor seeking to invest in the credits of the Protection Buyer, which will generate cash flow unless the original debtor defaults. The special purpose entity (SPE) sells protection to the protection buyer through a credit default swap (CDS) contract. Simultaneously, the SPE issues credit-linked notes (CLNs) that offer a predetermined spread as long as the protection buyer does not trigger the underlying CDS due do the default of its debtor. For the investor, the CLN arrangement closely resembles an investment into a debt instrument issued by the protection buyer (*see* Traditional securitisation).[42] However, in the event of default by the protection buyer, it is the investor who bears the loss.[43]

Synthetic securitisation facilitates the achievement of the same objective as true-sale securitisation, but without the complexities associated with transferring assets across multiple jurisdictions. However, the drawback of this structure is the absence, and sometimes the impossibility, of conducting due diligence to determine the ultimate bearer of the credit risk.

(c) Whole-business securitisation

The concept of whole business securitisation (WBS) emerged in the United Kingdom in the 1990s with the securitisation of cash flows from nursing homes while expanding subsequently to encompass various sectors such as pubs, hospitals, entertainment and amusement sites,

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[40] *Idem.*
[41] Bomfim, A.N. (2005), p. 124.
[42] Bomfim, A.N. (2005), pp. 123-126.
[43] *Idem.*

airports, theatres, and ferry services.[44] Despite its prevalence in Europe, the market for whole business securitisation remains predominantly concentrated in the United Kingdom.[45]

Whole business securitisation is also referred to as corporate securitisation or operating revenues securitisation due to having at its core the securitisation of a leveraged buyout (LBO), enabling the capture of the residual value of a business and the creation of securities representing this value.[46] The versatility of this approach allows for its application to the cash flow of nearly any business, surpassing the traditional limitations of securitisation and extending its scope to businesses that meet specific criteria.[47] From an objective standpoint, there is minimal distinction between a plain secured borrowing arrangement and whole business securitisation since the goal is to repay the securities principal and yield through the entire cash flow generated by the business, yet in WBS there is no need to isolate the originator's assets and transfer them to the SPE.[48] In other words, investors possess a claim over the entire cash flow of the securitised business, along with the assets generating the cash flow.[49] The key distinction between secured lending and whole business securitisation lies in the fact that, in the latter case investors, through the SPE, have legal control over the securitised business.[50] In WBS the Originator transfers for instance franchise agreements or trademark related claims to the SPE which in turn has power over the business of the franchisee as laid out in the franchise agreement. This allows the SPE to effectively assume the role of franchisor towards the securitised business to all effects, which is especially relevant in the event of default of the franchisee.

Having outlined the economic aspects of the most prominent securitisation structures, which effectively reveals the rationale behind these transactions, it is a crucial step to obtain a comprehensive overview of the relevant national and supranational (or *sui generis*) sources of law which govern securitisation in the legal systems chosen for this comparative analysis.

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[44] Fabozzi, F. J. and Kothari, V. (2008), p. 195.
[45] *Idem.*
[46] *Idem.*
[47] *Idem.*
[48] *Op. cit.,* p. 196.
[49] *Idem.*
[50] *Idem.*

3. History

Despite having earlier precedents, modern day securitisation began in 1970 when the US Department of Housing and Urban Development created the first modern residential mortgage-backed securities and the Government National Mortgage Association (GNMA) sold securities backed by a portfolio of mortgage loans.[51] It pooled mortgage loans and allowed them to be used as collateral for securities sold into the secondary market.[52] Congress later created the Federal Home Loan Mortgage Corporation (FHLMC) to assist in managing interest rate risk by purchasing mortgages.[53] The Emergency Home Finance Act of 1970 expanded the secondary mortgage market and authorised Federal National Mortgage Association (FNMA) and FHLMC to trade mortgages insured or guaranteed by the federal government.[54] In 1971 FHLMC issued the first conventional loan securitisation while Bank of America issued the first private label residential mortgage pass-through bond in 1977.[55] In the 1980s the first securitisation of automobile loans and bank credit card receivables was done, and commercial banks developed the first asset-backed commercial paper conduits (ABCPs).[56] These are a type of short-term debt security that is backed by a pool of underlying assets, such as loans, credit card receivables, or other financial assets who serve as collateral, providing a degree of security for investors. The government's involvement had the goal to promote home ownership by stimulating the mortgage market.

The securitisation market saw an overwhelming increase in the 90's mainly due to deregulation and the addition of institutional Investors such as pension funds or insurance companies to the market.[57] This was the decade in which Japan and the UK, among other countries, amended their respective legislation in order to enable securitisation.[58] The UK government used securitisation mainly to privatise and outsource certain governmental functions.[59] Commercial mortgage loans and an increasing number of sub-prime loans began to be securitised, which shall play a major role in the subsequent economic crisis.[60] Since receivables were sold to large pools and managed by SPEs, if the debtor happened to have problems with repaying the loan,

[51] Kaplan, C. M. (2014) Securitisation: A Brief History and the Road Ahead.
[52] *Idem.*
[53] Baker McKenzie (2022), pp. 1-3.
[54] *Idem.*
[55] Pizzutilo, F. (2002), pp. 7-10.
[56] *Idem.*
[57] Kaplan, C. M. (2014)
[58] *Idem.*
[59] *Idem.*
[60] Pizzutilo, F. (2002), pp. 7-10.

they could not work it out with their bank since it is not the title holder anymore, thus resulting in the alienation of the original two parties to the agreement.[61] Rather than finding a solution tailored to the individual borrower, the rigid provisions set out in the agreements had to be enforced, often to the detriment of the borrower.[62]

The rapid evolution of securitisation and its lacking regulation allowed for a myriad of transactions inside the securitisation structures rendering it oftentimes unclear what party bore the risk in each transaction.[63] That, alongside the rigid enforcement of the remedies provided in the agreements for cases of repayment failure, entailed a sequential default of debt that ravaged through the whole economy.[64] With the defaulting of a significant number of loans (especially home loan agreements collateralised by mortgages) debtors lost their homes, Originators avoided bankruptcies mostly through government bailouts and Investors claimed damages.[65] The key takeaways of the crisis were (a) Originators needed better due diligence for assets and practices before approving loans, (b) the rigidity of enforcing remedies had to be revised and (c) there had to be more clarity on the localisation of risk.[66] Considering the circumstances many national governments and the EU have pushed for a stricter regulation of securitisation.

Securitisation played a significant role in the aftermath of the pandemic-induced financial crisis in the EU. The pandemic caused a severe economic downturn, leading to increased defaults on loans and a decline in the value of assets, which in turn caused a lack of confidence in the financial system.[67] Securitisation will help to spread risk among a larger group of Investors, reducing the impact of defaults on any one lender.[68] Additionally, securitisation will allow banks to raise capital by selling these securities, which aids in stabilising the financial markets and support economic recovery.[69] While it started as a goal-oriented government intervention securitisation rapidly developed into a well-established technique for risk management and liquidity procurement. Despite having been denigrated in the aftermath of the 2008 Financial

[61] *Idem.*
[62] *Idem.*
[63] Kaplan, C. M. (2014)
[64] *Idem.*
[65] *Idem.*
[66] De Vries Robbé, J.J. (2008), pp. 3-5.
[67] Rec. (2) SECR II (*see* footnote Nr. 98)
[68] Joint Committee of the European Supervisory Authorities (2021) Joint Committee Report On The Implementation And Functioning Of The Securitisation Regulation (Article 44), Final report, JC 2021 31, pp. 63-66.
[69] *Idem.*

Crisis, after significant regulation was imposed in the EU it managed to re-emerge as a reliable and powerful tool for combating the adverse market effects, such as the COVID-19 Pandemic.

4. Legislative Framework for Securitisation

Due to the multidisciplinary and complex nature of securitisation transactions, national legislations should tend towards codifying their essential aspects in one single body of law. Not all legal systems have enacted such legislation, as it shall be explained in the following paragraphs. The EU has the unique ability to intervene in national legal systems in matters of market regulation both through regulations and directives, as was the case with securitisations and adjacent aspects thereof. In the analysis of national legislations, Croatia was chosen for it being a young market economy which has speedily joined an international community of advanced economies which have long operated with advanced financial instruments. The choice of Luxembourg is grounded on what can be considered, for European civil law standards, an advanced implementation of securitisations in practice. In order to fortify the international aspect of this legal analysis of securitisation, some considerations regarding the history of securitisations in the United States of America were made under "History". The latter is grounded precisely on the fact that the subject of this work originated in the US economy.

(a) Securitisation in the European Union

The EU purposefully chose to unify certain aspects of securitisation transactions directly through targeted regulations while other aspects were indirectly encompassed by the substantive scope of a number of regulations or directives. Examples for the latter are the so-called Capital Requirements Regulation (CRR) and Prospectus Regulation, whose impact on securitisation will be covered later to a limited extent as deemed relevant for this subject.[70] From a functional perspective, in spite of the bad reputation it acquired after the latest financial crisis, securitisation is regarded as an effective tool to mitigate the effects of the economic instabilities caused by the pandemic in order to help the recovery from the COVID-19 crisis.[71]

[70] *Idem.*
[71] Rec. (1) SECR II (*see* footnote Nr. 98)

i. Regulation (EU) 2017/2402 (the Securitisation Regulation)

In the year 2017, having felt the aftermath of the 2008 Financial Crisis and in order to restart the high-quality securitisation market and avoid past mistakes, the European Parliament and Council had introduced Regulation (EU) 2017/24022 laying down a general framework for securitisation, also known as Securitisation Regulation (SECR). It aims at establishing a harmonized framework for securitisation transactions within the EU by promoting transparency, standardization, and sound risk retention requirements. [72] The scope of application of SECR are securitisation transactions where the securities are issued on or after 1 January 2019, and where at least one of the parties involved is established in the EU.[73] SECR "defines securitisation and establishes due-diligence, risk-retention and transparency requirements for parties involved in securitisations, criteria for credit granting, requirements for selling securitisations to retail clients, a ban on re-securitisation, requirements for SSPEs[74] as well as conditions and procedures for securitisation repositories. It also creates a specific framework for simple, transparent, and standardised (STS) securitisation."[75] The function of the Securitisation Regulation is to establish a set of rules and requirements governing securitisation transactions, with the overall focus being on the achievement of financial stability and investor protection.

The SECR defines securitisation broadly as "a transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranched, having all of the following characteristics: payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures, the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme, and the transaction

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[72] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012. ELI: http://data.europa.eu/eli/reg/2017/2402/oj (henceforth: SECR)

[73] Art. 43(1) SECR

[74] The Securitisation Special Purpose Entities (SSPEs) are defined as a corporation, trust or other entity, other than an originator or sponsor, established for the purpose of carrying out one or more securitisations, the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the SSPE from those of the originator. (Art. 2(2) SECR)

[75] Art. 1(1) SECR

or scheme does not create exposures which possess all of the characteristics[76] listed in the Regulation (EU) 575/2013 (Capital Requirements Regulation).[77]

The SECR introduces two general restrictions, one for retail clients and the other for SPEs established in third countries. The sale of securitisation positions to retail clients is prohibited unless the seller has performed a suitability test[78] and is satisfied on the basis of the test that the securitisation position is suitable for that retail client, and the seller immediately communicates in a report to the retail client the outcome of the suitability test.[79] Provided the former criteria are fulfilled, if the client's retail portfolio does not exceed €500.000 (based on information provided by the client themselves) the seller has to ensure that no more than 10% of the client's portfolio are invested in securitisations.[80] The SECR does not, however, specify the manner in which the seller is supposed to ensure those limitations nor does it provide sanctions for such transgressions by the seller. Regarding SSPEs the regulation mandates that they shall not be established in a third country which either is listed as a high-risk and non-cooperative jurisdiction by the Financial Action Task Force on Money Laundering (FATF), or has not signed an agreement with a member state to ensure that the third country complies with the standards provided in the OECD Model Tax Convention on Income and on Capital[81] or in the OECD Model Agreement on the Exchange of Information on Tax Matters, while at the same time ensuring an effective exchange of information on tax matters.[82]

Provisions of the SECR which apply to all securitisations include due-diligence requirements for institutional investors, risk retention, transparency requirements for all parties, a ban on re-securitisation, and criteria for credit-granting.[83] Transparency requirements include the

[76] As per Art. 2(1) SECR, the characteristic listed in Art. 147(8) CRR encompass exposures which belong to an entity which was created specifically to finance or operate physical assets or is an economically comparable exposure, the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate, and the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.
[77] Art. 2(1) SECR
[78] A suitability test is the seller's practice of acquiring necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, that person's financial situation including his ability to bear losses, and his investment objectives including his risk tolerance so as to enable the investment firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him and, in particular, are in accordance with his risk tolerance and ability to bear losses. (Art. 25(2) Directive 2014/65/EU, ELI: http://data.europa.eu/eli/dir/2014/65/oj)
[79] Art. 3(1) SECR
[80] Art. 3(2) SECR
[81] Exchange of foreseeably relevant information for carrying out the provisions of the Convention itself or enforcing domestic laws concerning taxation all aimed at preventing tax evasion and avoidance (Art. 26(1) OECD Model Tax Convention on Income and on Capital, Condensed Version 2017).
[82] Art. 4 SECR
[83] Arts. 5-9 SECR

obligation to provide investors with comprehensive and standardized information about securitisation exposures through securitisation repositories (SRs) which centrally collect and keep the records of securitisation instruments and their underlying assets.[84] This function aims to ensure that investors have access to relevant and reliable information to assess the risks associated with securitisation transactions. The conditions and procedures relating to the registration of such securitisation repositories through the European Securities and Markets Authority (ESMA)[85] are regulated by Chapter 3 SECR. In art. 14 SECR extends the powers conferred to ESMA by Regulation (EU) 648/2012 on OTC derivatives, central counterparties, and trade repositories[86] to SECR with regard to information requests, investigations, on-site inspections, fines, penalties and related hearings, supervisory measures, and delegation of tasks to competent authorities. Sound risk management practices are promoted by mandating risk retention requirements, meaning that originators, sponsors, and original lenders must retain a material net economic interest in the securitized exposures of at least 5%.[87] The intended function of the latter provision is to align the interests of the parties involved, prevent excessive risk-taking, and improve the quality of securitized assets. This reactionary provision relates to past practices of excessive risk-taking by securitising underperforming assets with high default probability in the pursuit of disposing of them at the expense of investors.

The SECR establishes in Chapter 4 the criteria which securitisation need to satisfy in order to be labelled as simple, transparent, and standardized (STS) by the seller. A securitisation can be considered STS only where (i) it meets all the requirements relating to simplicity, standardisation, and transparency, (ii) that ESMA has been notified about the STS securitisation, and (iii) that the securitisation is included in the list of STS securitisations held by ESMA on its official website.[88] For a securitisation to be considered STS, the originator, sponsor and SSPE involved cumulatively need to be established in the Union.[89] This function encourages the origination of high-quality securitisation products with trackable risk concentration.

[84] Art. 7(2) SECR
[85] Established by Regulation (EU) No 1095/2010. ELI: http://data.europa.eu/eli/reg/2010/1095/oj
[86] *See* footnote Nr. 132
[87] Art. 6(1) SECR
[88] Art. 18(1) SECR
[89] Art. 18(2) SECR

Particular attention is given to the supervision of the implementation of the same SECR where in Chapter 5 the regulation designates the competent supervisory authorities (ESMA, EBA[90] and EIOPA[91]) and their powers, mandates macroprudential oversight of the securitisation market, mandates the imposition of administrative sanctions and remedial measures by member states (unless such infringements are subject to criminal sanctions), mandates notification and cooperation duties for member states.[92]

Finally, SECR intervenes in other EU legislation by amending directives on undertakings for collective investment in transferable securities (UCITS), on insurance and reinsurance (Solvency II) and on Alternative Investment Fund Managers (AFIM).[93] It also amends regulations on credit rating agencies, and on OTC derivatives, central counterparties, and trade repositories.[94]

ii. Regulation (EU) 2021/557 (the Amendment to the Securitisation Regulation)

Regulation (EU) 2021/557 of the European Parliament and of the Council, commonly referred to as the Securitisation Regulation II (SECR II), serves as an amendment to the existing Securitisation Regulation.[95] In the aftermath of the Covid-19 pandemic, the EBA stated in its Opinion on the Regulatory Treatment of Non-Performing Exposure Securitisation, that risks associated with the assets backing non-performing exposures (NPE)[96] securitisations are economically distinct from those of securitisations of performing assets. "These are securitised at a discount on their nominal or outstanding value and reflect the market's assessment of the likelihood of the debt workout generating sufficient cash flow and asset recovery, among other. The actual risk of loss for investors does, therefore, not represent the nominal value of the

[90] The European Banking Authority is an EU agency tasked with the implementation of standards and rules to regulate and supervise banking across member states, established by Regulation (EU) No 1093/2010. ELI: http://data.europa.eu/eli/reg/2010/1093/oj
[91] The European Insurance and Occupational Pensions Authority was established by Regulation (EU) 1094/2010. ELI: http://data.europa.eu/eli/reg/2010/1094/oj
[92] Art. 33 SECR
[93] Arts. 38, 39 and 41 SECR
[94] Arts. 40 and 42 SECR
[95] Regulation (EU) 2021/557 of the European Parliament and of the Council of 31 March 2021 amending Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation to help the recovery from the COVID-19 crisis, PE/70/2020/REV/1. ELI: http://data.europa.eu/eli/reg/2021/557/oj (henceforth: SECR II)
[96] These are loans, debts, or assets held by banks or financial institutions that are in default or facing significant difficulties in meeting their contractual payment obligations. They are considered non-performing when the borrower has failed to make principal or interest payments for a specified period, usually 90 days or more and are typically associated with higher credit risk and are considered problematic for the lender as they can lead to potential losses.

portfolio, but the discounted value, namely, net of the price discount at which the underlying assets are transferred. The difference in value accounts for the higher loss potential which is in this way hedged against its nominal value. It is therefore appropriate, in the case of NPE securitisations, to calculate the amount of the risk retention on the grounds of that discounted value."[97]

The SECR II aims to enhance the legal framework governing securitization activities within the EU by expanding its labelling of STS securitisations to synthetic securitisations.[98] The necessity to intervene in SECR is rooted in the incompatibility of certain requirements for STS traditional securitisations for STS on-balance-sheet (synthetic) securitisations. That is particularly exalted by the fact that, in synthetic securitisations, the risk transfer is achieved via a credit protection agreement (*see above*) instead of a sale of the underlying assets.[99] Furthermore, the SECR II recognises the necessity to introduce a set of new requirements, specific to synthetic securitisations, to ensure that the STS framework targets only on-balance-sheet synthetic securitisations and that the credit protection agreement is structured to adequately protect the position of both the originator and the investor.[100]

This amending regulation intervened in the general provisions of SECR by defining, among others, NPEs and credit protection agreements.[101] Requirements for SPEs, due-diligence requirements for institutional investors, and risk retention have been refined and strengthened.[102] Most prominently a new section 2a was added in Chapter 4 SECR codifying the requirements for STS on-balance-sheet securitisations which resolves the difficulties identified by the EBA in lieu of NPEs by expanding STS to synthetic securitisations.[103] The SECR II affirmed the European Systemic risk Board (ESRB)[104] responsibility for securitisation market macroprudential oversight in the EU and added that ESRB shall provide warnings and issue recommendations for remedial action in response to systemic risks to financial stability.[105] Transitional provisions for STS on-balance-sheet securitisations allow the use of

[97] Opinion of the European Banking Authority to the European Commission on the Regulatory Treatment of Non-Performing Exposure Securitisations, EBA-OP-2019-13, published on 23 October 2019.
[98] Rec. (30) SECR II
[99] Rec (13) SECR II
[100] *Idem.*
[101] Art. 1(1) SECR II
[102] Art. 1(2-9) SECR II
[103] Art. 1(10) SECR II
[104] European Systemic risk Board, established by Regulation (EU) 1092/2010. ELI: http://data.europa.eu/eli/reg/2010/1092/oj
[105] Art. 1(15) SECR II

the label "STS" or "simple, transparent and standardised" even for synthetic securitisations whose credit protection agreement has become effective before 9 April 2021, or the initial securitisation positions of which were created before that date.[106] In conclusion SECR II mandated that EBA, in cooperation with ESMA and EIOPA publishes a report by 1 November 2021, which should aide the development of a specific sustainable securitisation framework for the purpose of integrating sustainability-related transparency requirements into SECR.[107] The amendments analysed in the text above have entered into force on 3 April 2021.[108]

iii. Regulation (EU) 2017/2401 (the Securitisation Prudential Regulation)

Regulation (EU) 2017/2401, also referred to as Securitisation Prudential Regulation (SPR)[109] is an amendment to Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms, also known as Capital Requirements Regulation (CRR)[110]. Securitisations are once again recognised as an important part of a well-functioning financial market insofar as they contribute to the diversification of funding and risk while releasing regulatory capital which can then be reallocated to support further lending.[111]

In line with the Basel III framework[112], the CRR lays down uniform rules regarding general prudential requirements that credit institution or investment firms shall comply with in relation a number of items, such as credit risk, market risk, operational risk, settlement risk, liquidity risk, large exposures limitations, reporting requirements, and public disclosure requirements.[113] The SPR introduces methodologies tailored for the calculation of risk-weighted exposure and expected loss amounts relating to securitisations.[114] It aims to improve risk management practices and ensure the robustness of risk-weighted capital requirements by establishing a framework of specifying conditions and internal models for the calculation of own funds

[106] Art. 1(17) SECR II
[107] Art. 1(20) SECR II
[108] Art. 2 SECR II
[109] Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms. ELI: http://data.europa.eu/eli/reg/2017/2401/oj (henceforth: SPR)
[110] Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) 648/2012, text with EEA relevance. ELI: http://data.europa.eu/eli/reg/2013/575/oj (henceforth: CRR)
[111] Rec. (1) SPR
[112] Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision (BCBS) in response to the 2008 Financial Crisis, for more details consult the BCBSs website https://www.bis.org/bcbs/basel3.htm.
[113] Art. 1(1) CRR
[114] Art. 1(9) SPR (amending Art. 244 CRR)

requirements.[115] This provision sets out requirements for the use of internal models, including the need for institutions to demonstrate their ability to adequately capture and manage risks.

The SPR also introduces provisions aimed at enhancing the ability of institutions to withstand financial stress by establishing stricter requirements for institutions' liquidity coverage ratios (LCR).[116] This amendment ensures that institutions maintain sufficient high-quality liquid assets to meet their liquidity needs under stress conditions. By aligning the regulatory framework with international standards and strengthening risk management and capital requirements, the SPR aims to enhance the resilience, stability, and soundness of the EU banking sector.

iv. Regulation (EU) 2017/1129 (the Prospectus Regulation)

The financial market operates on a prudently calculated risk margin, which is regulated by the CRR as was elucidated above. In order to determine the factual substrate needed for these calculations, the potential investors in such financial instruments must be able to understand the elements regarding a certain emission of securities, which in the case of a public emission is achieved through consulting the tender which accompanies it.[117] The prospectus is a formal document that provides details about an investment offering to the public, including stocks, bonds, and mutual funds.[118] Since the requirements for publication of *prospecti* and their formal and substantial aspects are diversely regulated among national jurisdictions, the EU intervened by uniformly codifying them in Regulation (EU) 2017/1129, commonly referred to as the Prospectus Regulation.[119] The objectives of this regulation are to enhance investor protection and market efficiency as it is crucial to the establishment of the Capital Markets Union.[120]

The Prospectus Regulation codifies a consistent regulatory framework for the preparation, approval, and distribution of *prospecti*.[121] In terms of territorial scope, it applies to securities offered to the public or admitted to trading on a regulated market situated in a Member State

[115] Art. 1(10) SPR (amending Art. 337 CRR)
[116] Art. 1(9) SPR (amending Article 265 CRR)
[117] Miladin, P. (2013), pp. 133-178.
[118] *Idem.*
[119] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC, text with EEA relevance. ELI: http://data.europa.eu/eli/reg/2017/1129/oj (henceforth: Prospectus Regulation)
[120] Rec. (87) Prospectus Regulation
[121] Art. 1(1) Prospectus Regulation

after its entry into force on 20 July 2017.[122] Since the regulation was aimed at corporate security emissions, a number of public interest related securities types are excluded from its application.[123] It also does not apply to securities offered to the public with a total consideration of less than € 1.000.000 in the Union over a period of 12 months.[124]

One of the aims of the Prospectus Regulation is to enhance investor protection by ensuring the provision of accurate and comprehensive information. The regulation introduces proportionate disclosure requirements tailored to the type and size of the offering.[125] It also introduces a summary section in the prospectus, providing concise and understandable information for investors.[126] A single passport mechanism is established allowing issuers to use a single prospectus approved by their home competent authority to offer securities in multiple member states.[127] This mechanism reduces the administrative burden for issuers and facilitates access to capital markets for businesses across the EU. Moreover, the Prospectus Regulation empowers ESMA to oversee and coordinate the prospectus regime across the EU by granting it powers, including the development of guidelines and recommendations to ensure consistent application of the regulation.[128]

In summary, the function of the Prospectus Regulation is to harmonize and streamline the prospectus regime for securities offerings within the EU. The regulation aims to enhance investor protection, facilitate cross-border offerings, and promote market efficiency by introducing proportionate disclosure requirements, establishing a single passport mechanism, addressing prospectus liability, and empowering ESMA for oversight and coordination. By providing a consistent and transparent framework, the Prospectus Regulation aims to foster investor confidence, facilitate access to capital markets, and contribute to the overall functioning and integration of EU financial markets.

[122] *Idem.*
[123] Art. 1(2) Prospectus Regulation
[124] Art. 1(3) Prospectus Regulation
[125] Art. 6 Prospectus Regulation
[126] Art. 7 Prospectus Regulation
[127] Arts. 24-27 Prospectus regulation
[128] Arts. 31-37 Prospectus Regulation

v. *Regulation (EU) 648/2012 (European Market Infrastructure Regulation)*

Securitisation SPEs are encompassed by the European Market Infrastructure Regulation[129] (EMIR), especially through provisions concerning clearing and reporting requirements.[130] With regard to its subject matter, EMIR lays down clearing and bilateral risk-management requirements for over-the-counter derivative contracts, reporting requirements for derivative contracts, and uniform requirements for the performance of activities of central counterparties (CCPs) and trade repositories.[131] The broad scope of the regulation is oriented towards CCPs and their clearing members, financial counterparties, trade repositories, and non-financial counterparties and trading venues.[132]

vi. *Non-legislative acts*

An important document worth mentioning in the context of EU securitisation regulation is the Commission Implementing Regulation (EU) 2020/1227 laying down implementing technical standards with regard to templates for the provision of information in accordance with the STS notification requirements, as amended by Commission Implementing Regulation (EU) 2022/1929 of 31 March 2022.[133] It's aim is to harmonise the exchange of notifications which contain information regarding securitisations meeting the requirements on simple, transparent and standardised criteria as set out in SECR.[134]

[129] Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on over the counter (OTC) derivatives, central counterparties (CCPs) and trade repositories, text with EEA relevance. ELI: http://data.europa.eu/eli/reg/2012/648/oj (henceforth: EMIR)
[130] Zanev, V. and Taillefer, N. (2023) Luxembourg: Law & Practice. Chambers global practice guides: Securitisation 2023, p. 15.
[131] Art. 1(1) EMIR
[132] Art. 1(2) EMIR
[133] ELI: http://data.europa.eu/eli/reg_impl/2022/1929/oj
[134] Rec. (1) Commission Implementing Regulation (EU) 2020/1227 laying down implementing technical standards with regard to templates for the provision of information in accordance with the STS notification requirements. ELI: http://data.europa.eu/eli/reg_impl/2020/1227/oj

(b) Securitisation in Croatia

In 2007 the Croatian government had drafted a Securitisation Act (*Zakon o sekuritizaciji*) which should have given this financing operation a general framework in the Croatian legal system.[135] It was supposed to be an example of regulatory collaboration between the public and private sectors, representatives from the Ministry of Finance, the Croatian Financial Services Supervisory Agency (HANFA), the Croatian National Bank (CNB), the Croatian Banking Association, as well as external consultants from the World Bank, the European Bank for Reconstruction and Development (EBRD), and the German Development Bank (KfW) were involved in the process. [136] Although most of the draft had already been completed in late 2006, the working group responsible for drafting the securitisation act had difficulties addressing several issues including: obtaining debtor consent for the transfer of receivable from the creditor (bank) to another entity (the SPE), the tax treatment of such transactions, the selection of security types, determining who could participate in securitisation transactions, and the criteria for licensing SPEs (structured supposedly akin to investment or pension funds, meaning legal entities or separate estates managed by an asset management company).[137] The enactment of the Croatian Securitisation Act had failed in the wake of the 2008 Financial Crisis. Crucial for the regulation of securitisation in the Croatian legal system was the country's accession to the EU on 1 July 2013 activating the direct applicability, in accordance with Art. 288(2) TFEU[138], of all the key regulations regarding the subject matter. It is in the wake of the latter events that the following documents were enacted by the national legislature in correlation with EU Law.

i. Securitisation Regulation Enforcement Act (Zakon o provedbi Uredbe EU)

The SECR defers to member states the determination of competent national authorities, their powers, the cooperation between competent authorities, administrative sanctions and transparency requirements for private securitisations.[139] In Croatia all of the above is regulated by the Securitisation Regulation Enforcement Act (SECR-EA) which was enacted on 5 June

[135] Ministarstvo financija Republike Hrvatske (2006) Nacrt zakona o sekuritizaciji do kraja ove godine. Available at: https://mfin.gov.hr/vijesti/979 (Accessed 20.06.2023.)
[136] *Idem.*
[137] *Idem.*
[138] Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47-390. ELI: http://data.europa.eu/eli/treaty/tfeu_2012/oj
[139] Arts. 29(5) and 32 SECR

2020.[140] The designated competent authorities in accordance with Art. 29(5) SECR are the Croatian Financial Services Supervisory Agency (*Hrvatska agencija za nadzor financijskih usluga* or HANFA) and the Croatian National Bank (*Hrvatska narodna banka* or CNB).[141] The persons subject to HANFA's monitoring are defined in Art. 6 SECR-EA and include insurance companies, alternative investment funds, UCITS funds, pension funds, investment companies, leasing and factoring companies, credit institutions as servicers, and the Central Depository and Clearing Company Inc (*Središnje klirinško depozitarno društvo* or SKDD)[142] while the CNB monitors credit institutions acting either as sponsors or investors in securitisation positions and SPEs founded by credit institutions.[143] HANFA was tasked with monitoring the fulfilment of due-diligence, risk retention, and contingent requirements of subjects under their competence[144] while the National bank's competences lie in monitoring the fulfilment of due diligence requirements, pronouncing administrative sanctions, information exchange with ESMA, EBA and EIOPA. Both supervising authorities are tasked with pressing misdemeanour charges for SECR and SECR-EA violations, each in its own operating domain.[145] In the following articles SECR-EA proceeds with defining in detail the monitoring procedures and measures at the competent authorities' disposal, the language used for delivering and publishing securitisation notices, supervision fees, and substantive provisions for misdemeanours and relating administrative sanctions. There seems to be no significant deviation in the legislative rationale between the SECR-EA and the SECR.

ii. HANFA Securitisation Bylaw (Pravilnik HANFA-e o sekuritizacijama)

On 14 August 2021 the Bylaw on re-securitisation, disclosure of information on private securitisations and websites, and issuance of approvals to third parties verifying STS compliance (*Pravilnik o resekuritizaciji, objavi informacija o privatnim sekuritizacijama i mrežnim stranicama te izdavanju odobrenja trećim stranama koje provjeravaju STS usklađenost*) was promulgated by HANFA with the goal to regulate a number of details foreseen by SECR-EA.[146] It prescribes the contents of the applications for re-securitisation

[140] Zakon o provedbi Uredbe (EU) 2017/2402 o utvrđivanju općeg okvira za sekuritizaciju i o uspostavi specifičnog okvira za jednostavnu, transparentnu i standardiziranu sekuritizaciju, "Narodne novine" br. 63/2020., 126/2021. (henceforth: SECR-EA)
[141] Art. 5(1) SECR-EA
[142] Art. 6(1) subparaghraphs 1-13 SECR-EA
[143] Art. 6(2)
[144] Art. 7 SECR-EA
[145] Art. 8 SECR-EA
[146] Pravilnik o resekuritizaciji, objavi informacija o privatnim sekuritizacijama i mrežnim stranicama te izdavanju odobrenja trećim stranama koje provjeravaju STS usklađenost, "Narodne novine" br. 88/2021. (henceforth: Securitisation Bylaw)

prohibition and information disclosure exemption, the manner of disclosing required information, the requirements for websites where securitisation notices are published, and the content of the application for issuing approval to third parties verifying STS compliance, with regard to HANFA's competences defined in the SECR-EA.[147]

Re-securitisation, meaning the securitisation of securitisation positions, is eligeable for approval under the condition that the applicant demonstrates that re-securitisation will be used for legitimate purposes[148] in which case, upon request, HANFA may grant said exemption.[149] Purposes deemed legitimate in accordance with SECR are the facilitation of the winding-up of a credit institution, an investment firm or a financial institution, ensuring the viability in order to avoid its winding-up, and where the underlying exposures are non-performing, the preservation of the interests of investors.[150] Additionally, the SECR foresees the eventual expansion of said list through regulatory technical standards developed by ESMA.[151] With regard to private securitisations[152] and disclosure requirements, the Securitisation Bylaw allows for an exemption from the obligation to disclose information on private securitisations provided the applicant obtains HANFA's permission.

iii. CNB Securitisation Decree (Odluka HNB-a o sekuritizacijama)

In accordance with SECR and the Croatian National Bank Act[153] the governor of the CNB has promulgated the Decree on re-securitisation, disclosure of information on private securitisations, websites, and supervision fees (*Odluka o resekuritizaciji, objavi informacija o privatnim sekuritizacijama, mrežnim stranicama i o naknadama za nadzor*), henceforth referred to as Securitisation Decree.[154]The Securitisation Decree applies to credit institutions

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[147] Art. 1 Securitisation Bylaw
[148] The purpose is deemed legitimate if it facilitates the winding-up of a credit institution, an investment firm or a financial institution, ensures the viability as a going concern of a credit institution, an investment firm or a financial institution in order to avoid its winding-up, or where the underlying exposures are non-performing, preserves the interests of investors (Art. 8(3) SECR). A supplement list of legitimate reasons may be developed by ESMA through draft regulatory technical standards (Art. 8(5) SECR). These conditions are also referred to by art. 5 of the Securitisation Bylaw.
[149] Art. 5 Securitisation Bylaw
[150] Art. 6 Securitisation Bylaw
[151] Art. 8(5) SECR, as indicated by Art. 6 of the Securitisation Bylaw.
[152] Private securitization are such transactions between private parties which are not subject to disclosure obligations and mandatory prospectus publication as laid out it art. 7(2) SECR, allowing parties to enter into securitisation transactions without disclosing sensitive commercial information on the transaction (Rec. (13) SECR).
[153] Art. 43(2)(10) Zakon o Hrvatskoj narodnoj banci, "Narodne novine" br. 75/2008., 54/2013., 47/2020.
[154] Odluka o resekuritizaciji, objavi informacija o privatnim sekuritizacijama, mrežnim stranicama i o naknadama za nadzor, "Narodne novine" br. 87/2021., 56/2023. (henceforth: Securitisation Decree)

based in Croatia, except for those under direct supervision of the European Central Bank, and to SPEs established by such credit institutions.[155]

It prescribes the contents of the applications for re-securitisation prohibition and information disclosure exemption, the manner of disclosing required information, the requirements for websites, supervision fees, and the content of the application for an information disclosure exemption in cases where the supervised entity can prove that such a requirement would be disproportionately burdensome in terms of cost[156] (considering the size of the securitization issuance, the number and type of investors, and the nature of the underlying exposures).[157] This decree is substantially the equivalent of the bylaw described above, but with regard to the supervisory competences conferred to the CNB by the SECR-EA.

iv. Credit Institutions Act (Zakon o kreditnim institucijama)

The Credit Institutions Act regulates the supervision of credit institutions by the CNB, among other crucial elements forming the banking sector in Croatia.[158] Without diving excessively into detail, it is worth mentioning that the portions of the Credit Institutions Act regarding risk supervision and management contain multiple considerations regarding domestic and foreign securitisation arrangements which are tangent to Croatian credit institutions.[159]

v. Covered Bond Issuance Act (Zakon o izdavanju pokrivenih obveznica)

As was explained before, the issuance of securities is a crucial step of the securitisation operation. Since securitisation of real-estate related assets is the most common securitisation object-structure, the issuance of asset-backed bonds has a high likelihood of occurring due to the complementary maturity timespan of bonds. If such operation were to be arranged in Croatia it would entail the application of provisions laid out in the Covered Bond Issuance and Public Supervision Act (Zakon o izdavanju pokrivenih obveznica i javnom nadzoru pokrivenih obveznica), henceforth reffered to as CBI Act.[160] The CBI Act transposes Directive (EU)

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[155] Art. 2 Securitisation Decree
[156] *See* art. 16(3) SECR-EA and art. 7(1) SECR.
[157] Art. 1 Securitisation Decree
[158] Art. 1(3) Zakon o kreditnim institucijama, "Narodne novine" br. 159/2013., 19/2015., 102/2015., 15/2018., 70/2019., 47/2020., 146/2020., 151/2022. (henceforth: Credit Institutions Act)
[159] Arts. 69(1)(22), 103(2), 181(3) and 360(1)(69) Credit Institutions Act
[160] Zakon o izdavanju pokrivenih obveznica i javnom nadzoru pokrivenih obveznica, "Narodne novine" br. 53/2022. (henceforth: CBI Act)

2019/2162 on the issue of covered bonds and covered bond public supervision into Croatian law (henceforth: Covered Bonds Directive).[161]

The scope of the CBI Act is limited to asset-backed bonds issued by credit institutions domiciled in Croatia.[162] The definition of credit institution according to the Credit Institutions Act is an "undertaking the business of which is to take deposits or other repayable funds from the public and to grant credits for its own account".[163] *Per se* that definition would not apply to SPEs whose elements coincide rather with that of an investment firm (a legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis).[164] Since it is the SPE issuing bonds in a securitisation operation, one key questions that ought to be clarified by the Croatian legislator is whether a Croatian SPE would even be subject to the CBI Act. This arises from the lack of a specific designation of SPEs either by the Commercial Companies Act[165] or any relevant *leges speciales*, like the Credit Institutions Act, the Alternative Investment Funds Act[166] or the Act on Open-End Investment Funds and their Public Offering[167].

The CBI Act regulates the conditions for issuing covered bonds by credit institutions, which include issuance requirements, structural features of bonds, public supervision of covered bonds, disclosure requirements for covered bonds, and substantive provisions for misdemeanours regarding regulation violations.[168]

With regard to structural features of the bonds, the CBI Act substantialises bankruptcy remoteness and the asset pool backing the issuance (coverage pool). It defines the investor's claim against the issuer of the bond as the amount of the principal and the corresponding

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[161] Art. 2 CBI Act referring to Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU, text with EEA relevance. ELI: http://data.europa.eu/eli/dir/2019/2162/oj
[162] Art. 3 CBI Act
[163] Art. 3(1)(28) Credit Institutions Act refers to the definition provided in art. 4(1)(1) CRR.
[164] Art. 4(1)(2) CRR refers to the definition provided in art. 4(1)(1) Directive 2004/39/EC repealed by Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast), text with EEA relevance, ELI: http://data.europa.eu/eli/dir/2014/65/oj, which kept the cited definition.
[165] Zakon o trgovačkim društvima, "Narodne novine" br. 111/1993, 34/1999, 121/1999, 52/2000, 118/2003, 107/2007, 146/2008, 137/2009, 111/2012, 125/2011, 68/2013, 110/2015, 40/2019, 34/2022, 114/2022, 18/2023.
[166] Zakon o alternativnim investicijskim fondovima, "Narodne novine" br. 21/2018, 126/2019, 110/2021, 83/2023. (henceforth: AIF Act)
[167] Zakon o otvorenim investicijskim fondovima s javnom ponudom, "Narodne novine" br. 44/2016, 126/2019, 110/2021, 76/2022.
[168] Art. 1 CBI Act

interest, while the counterparty to a derivatives contract (*see above* Protection Seller) has a claim against the issuer of the covered bonds in accordance with the derivatives contract.[169] In the event of compulsory winding-up or restructuring of the issuer, investors in covered bonds and counterparties in derivatives contracts have a priority claim in the payment waterfall against the principal, as well as all matured, accrued, and future interest, from the coverage pool.[170] If the coverage pool is insufficient to fully satisfy the priority claims, investors in covered bonds and counterparties in derivatives contracts have a claim against the liquidation estate of the issuer as ordinary unsecured creditors of the issuer.[171] In case of insolvency, compulsory winding-up, or restructuring of the issuer, the claims related to covered bonds are not subject to automatic maturity acceleration, solely based on the fact that the issuer is insolvent or that a compulsory winding-up or restructuring procedure was initiated against the issuer.[172] Crucially, in the event of insolvency or compulsory winding-up of the issuer, the claims of investors and counterparties in derivatives contracts mature in accordance with the agreed terms and are paid from the coverage pool. [173] The coverage pool does not become part of the liquidation estate of the issuer.[174] Relating to the coverage pool the CBI Act mandates the issuer to ensure that the bonds are at all times covered by assets that are eligible in accordance with Article 129(1) CRR.[175]

The coverage pool relating to a covered bond issuance may exclusively consist of assets deemed adequate in accordance with the aforementioned CRR provision, while also having appropriate structural characteristics, maturity, and risk profile for securing covered bonds.[176] Additionally, the coverage pool may include assets that constitute a liquidity buffer and, under certain conditions, derivatives contracts.[177] The issuer must establish and update a coverage pool register containing data about the assets backing the bond issue.[178] Money and cash inflows from these assets are an integral part of the coverage pool.[179] The covered bonds issued

[169] Art. 5(1) CBI Act
[170] Art. 5(2) CBI Act
[171] Art. 5(3) CBI Act
[172] Art. 6(1) CBI Act
[173] Art. 6(2) CBI Act
[174] *Idem.*
[175] The detailed list of eligible assets can be synthetized into the following categories: exposures to / guaranteed by central governments, the ESCB central banks, public sector entities, regional governments or local authorities in the Union or third countries, and loans secured by residential property or commercial immovable property.
[176] Art. 9(1) CBI Act
[177] *Idem.*
[178] Art. 12(1) CBI Act
[179] Art. 9(2) CBI Act

according to the CBI Act must have a fixed maturity date.[180] Exceptionally, prorogations of the maturity date may be foreseen in case of compulsory winding up or restructuring of the issuer.[181] The issuer must provide information about the bond programme on their website, in order for investors to assess the risks involved and conduct due diligence on the issue.[182] HANFA's administrative board is yet to adopt a bylaw specifying the labels that issued covered bonds may or must use, depending on the predominant composition of the coverage pool as prescribed by Art. 9(3) CBI Act.[183]

Regarding the public supervision of covered bond issues, the CBI Act designates HANFA as the competent supervisory authority yet mandates a collaboration with the CNB in the execution of its supervisory tasks.[184] Before issuing a series of covered bonds, the issuer is required to apply for a preliminary opinion by the CNB after which it may request approval of the covered bond program by HANFA.[185] Procedural aspects of the latter will be regulated by a bylaw that HANFA's administrative board has yet to enact.[186] Regarding prospectus requirements, the CBI Act refers in Art. 24 to the relevant provisions of the Capital Markets Act which shall be explained below.[187] Violations of requirements laid out in the CBI Act and ascertained in a supervisory procedure conducted by HANFA officials will result in administrative sanctions which include fines, periodical penalties, or warnings.[188]

Chapter IV of the CBI Act is dedicated to specific provisions applicable in case of the compulsory winding-up of the issuer. The Compulsory Winding-up of Credit Institutions Act is the *lex generalis* governing said procedure.[189] Chapter V contains provisions regarding misdemeanours and the complimentary sanctions, while Chapter VI regulates the label "European Covered Bonds" and "European Covered Bonds (Premium)"[190], the requirements

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[180] Art. 17(1) CBI Act
[181] Art. 17(2) CBI Act
[182] Art. 14(1) CBI Act
[183] Based on the research conducted on 1 July 2023 there is no such bylaw. If such bylaw were to be enacted in the meantime it would be available on https://www.hanfa.hr/regulativa/trziste-kapitala/.
[184] Art. 18 CBI Act
[185] Art. 19(1) CBI Act
[186] *See* footnote Nr. 158.
[187] Zakon o tržištu kapitala, "Narodne novine" br. 65/2018., 17/2020., 83/2021. (henceforth: Capital Markets Act)
[188] Arts. 38(1) and 39 CBI Act
[189] Zakon o prisilnoj likvidaciji kreditnih institucija, "Narodne novine" br. 146/2020.
[190] European Covered Bonds are a specific type of debt security issued by banks or financial institutions in the EU which are typically backed by high-quality mortgages or public sector loans, which provide significant security to bondholders (Rec. (37) Directive (EU) 2019/2162). Key features of European Covered Bonds include the aforementioned segregated collateral (specific high-quality asset pool), dual recourse (in case of default by the issuer, bondholders may claim against both the issuer and the assets in the cover pool, and ring-fencing (the cover pool assets are kept separate from the issuer's own assets).

for which are defined by the CRR. Financial instruments currently labelled as "covered bond" will not continue to be considered such under the CBI Act.[191]

Besides those mentioned above, both the CNB and HANFA were required to produce a number of bylaws in accordance with the CBI Act until 14 November 2022[192], all of which have yet to be enacted with the exception of HANFA's Supervision Fee Bylaw for the year 2023.[193]

vi. Capital Markets Act (Zakon o tržištu kapitala)

The scope of the Capital Markets Act is as extensive as the name implies. Title III of the Act regarding public offering and disclosure requirements is therefore of particular interest for securitisation transactions, specifically Chapter I which regulates the *prospecti* for securities. The publication of a prospectus is a disclosure act by the issuer of a security with the purpose of enabling the assessment of all related risks and benefits by investors.

In accordance with the Prospectus Regulation, which is extensively referenced in the chapter, HANFA is designated as the competent enforcing authority.[194] The scope of the entire Title III coincides with that defined by the Prospectus Regulation, thus partially encompassing the preparation, approval, and distribution of *prospecti*, while most former specific provisions relating to *prospecti* contained in the Capital Markets Act itself were derogated by said regulation.[195]

Notably, in accordance with art. 3(2) of the Prospectus Regulation, the Capital Markets Act foresees an exemption from mandatory prospectus publication in case of public offers of securities whose total consideration does not exceed € 8.000.000,00 over a span of twelve months, and which are raised in the European Union.[196] It is necessary to notify HANFA for each exempted public offer carried out in Croatia.[197] The issuer or offeror are however obliged to produce and publish an information document in Croatian if the total consideration is greater than € 4.000.000,00 (but still lower than € 8.000.000,00) and does not fall within specific

[191] Art. 68(2) CBI Act
[192] Art. 70 CBI Act
[193] Pravilnik o izračunu, visini i naplati naknada koje se plaćaju Hrvatskoj agenciji za nadzor financijskih usluga za 2023. Godinu, "Narodne novine" br. 155/2022.
[194] Art. 405(1) Capital Markets Act
[195] Art. 408(1) Capital Markets Act
[196] Art. 409(1) Capital Markets Act
[197] Art. 409(2) Capital Markets Act

exempt cases[198]. Such information document must be regularly updated during the course of the offer.[199] The form and content of the information document as well as its publication and updating are regulated by HANFA's Information Document Bylaw.[200]

It is crucial to emphasise the provisions of the Capital Markets Act regulating prospectus related liability which entitles the respective investor to damages incurred through incorrect or incomplete information provided in the prospectus[201], or through the untimely publication or non-publication of the prospectus.[202]

vii. Taxation

The feasibility of a hypothetical Croatian securitisation is questionable due to potentially elevated costs, caused particularly by an uncertain tributary designation of the transaction. Neither the Corporate Gains Tax Act[203] nor the Corporate Gains Tax Bylaw[204] define securitisation as a separate category, yet an SPE as a corporate entity is certainly subject to corporate gains taxation in accordance with Art. 2(1) Corporate Gains Tax Act. All incoming cash-flow from securitised assets to the SPE is taxable as corporate gains if not deducted accordingly.[205] Deductible expenses do include interest payments on issued bonds[206], however these are limited to 30% of earnings before interest, tax, depreciation, and amortization (EBITDA) or to € 3.000.000,00 if more favourable.[207] Considering the 10% corporate gains tax rate for amounts under € 995.421,06 and 18% for amounts taxable above said threshold, tax neutrality is to be determined on a case-by-case basis. Services provided by the SPE in connection with the securitisation transaction may be subject to VAT, feasibility would require

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[198] *Exempli gratia*, those include offers addressed solely to qualified investors, addressed to fewer than 150 natural or legal persons, where the denomination per unit of security is greater than € 100.000, etc. (Art. 1(4) Prospectus Regulation)
[199] Art. 409(3-4) Capital Markets Act
[200] Pravilnik o minimalnom obliku i sadržaju informacijskog dokumenta kod iznimke od obveze objave prospekta, "Narodne novine" br. 87/2020.
[201] Art. 411 Capital Markets Act
[202] Art. 415 Capital Markets Act
[203] Zakon o porezu na dobit, "Narodne novine" br. 177/2004., 90/2005., 57/2006., 80/2010., 22/2012., 146/2008., 148/2013., 143/2014., 50/2016., 115/2016., 106/2018., 121/2019., 32/2020., 138/2020., 114/2022. (henceforth: Corporate Gains Tax Act)
[204] Pravilnik o porezu na dobit, "Narodne novine" br. 95/2005., 133/2007., 156/2008., 146/2009., 123/2010., 137/2011., 61/2012., 146/2012., 160/2013., 12/2014., 157/2014., 137/2015., 115/2016., 1/2017., 2/2018., 1/2019., 1/2020., 59/2020., 138/2020., 1/2021., 156/2022.
[205] Art. 5 Corporate Gains Tax Act
[206] Art. 32.a(3) Corporate Gains Tax Act
[207] Art. 32.a(1) Corporate Gains Tax Act

significant exemptions from VAT taxation of such services.[208] These considerations do not include the potential taxation of income generated on the investors' side by the bond yield.

Despite the absence of a *lex specialis* regulating securitisation, such an endeavour is possible under Croatian law since it is a construct of multiple simpler legal relations already regulated by other *leges generales et speciales*.[209] Crucially, the transfer of assets to the SPE must be irreversible in order to prevent claw-back provisions[210] in eventual insolvency procedures relating to the Originator.[211] The Croatian Civil Obligations Act does not require the notification of the debtor in order to perfect the transfer of a receivable, yet a lack thereof might cause the debtor to fulfil his obligation to the original creditor thus absolving the debtor from the obligation, while a claim is generated between the transferor and transferee.[212] An absence of clear provisions tailored to the specifics of securitisations and the fluctuating tendencies of jurisprudence may pose a significant problem for foreseeability. An issue potentially hindering the emission of real-estate backed securities, is the uncertainty related to property rights transcribed in the land registry.[213] With the enactment of the Ownership and other Property Rights Act in 1996, which was accompanied by other related acts, a transformation of r*ights in rem* constituted according to the laws of the former socialist Yugoslavia into property rights of the Roman / Germanic tradition was attempted.[214] Multiple complications arose due to the introduction of peculiarities such as extra-tabular ownership and land-use right claimed in accordance with the multiple *leges speciales* enacted in 1996 concurrently with the Ownership Act.[215] What is more, in some specific cases where the former social ownership (*društveno vlasništvo*) was referenced in the land register, the principle relating to the completeness and truthfulness of the land register was delayed until 1 January 2017.[216] This delay was justified

[208] For value added tax regulation *see*: Zakon o porezu na dodanu vrijednost, "Narodne novine" br. 73/2013, 99/2013, 148/2013, 153/2013, 143/2014, 115/2016, 106/2018, 121/2019, 138/2020, 39/2022, 113/2022, 33/2023.
[209] An in-depth explanation is offered in this work below, under Legal Qualification of a Traditional Securitisation Transaction.
[210] Claw-back provisions are legal actions taken by creditors or trustees in insolvency or bankruptcy proceedings aimed at recovering certain payments or transfers made by a debtor before or during the insolvency procedure in order to ensure equal treatment of creditors (*par conditio creditorum*) and prevent any illegitimate preferential treatment.
[211] *See* claw-back provisions (Title IV, Chapter III) of the Croatian Bankruptcy Act, Stečajni zakon, "Narodne novine" br. 71/2015, 104/2017, 36/2022.
[212] Art. 82(1) Zakon o obveznim odnosima, "Narodne novine" br. 35/2005, 41/2008, 125/2011, 78/2015, 29/2018, 126/2021, 114/2022, 156/2022.
[213] Jug, J. (2014) Pretvorba društvenog vlasništva na stvarima koje nisu procijenjene kod pretvorbe društvenih poduzeća, Zbornik Pravnog fakulteta Sveučilišta u Rijeci, Vol. 35, Nr. 1, pp. 359-361.
[214] *Op. cit.*, pp. 363-371.
[215] *Op. cit.*, pp. 385-386.
[216] Art. 388(5) Zakon o vlasništvu i drugim stvarnim pravima, "Narodne novine" br. 91/1996, 68/1998, 137/1999, 22/2000, 73/2000, 114/2001, 79/2006, 141/2006, 146/2008, 38/2009, 153/2009, 90/2010, 143/2012, 152/2014.

by the time needed to revise all relevant land parcels and transcribe into the land register all extra-tabular ownership rights belonging to the Republic of Croatia *ex lege*.[217] Regardless of the latter, there are significant discrepancies between the land registry and the cadastral register, often relating to qualitative and quantitative elements of land parcels (parcel numbers, borders and area) which does not explicitly go in hand with the prerequisites associated with complex transactions like securitisations. Nevertheless, with the development of the Croatian capital market and slow but steady stabilisation of legislation and jurisprudence, securitisations could become more attractive.

(c) Securitisation in Luxembourg

The Grand Dutchy of Luxembourg has significant experience with securitisation operations, a practice that the financial-sector oriented nation has perfected. It is the primary jurisdiction for European securitisations since it hosts 25% of all the continent's securitisation vehicles with approximately one thousand SPEs domiciled in the country.[218] As of April 2023 the *Commission de Surveillance du Secteur Financier* (CSSF) has already authorised 28 securitisation vehicles.[219]

i. Law of 22 March 2004 on Securitisation

Luxembourg's first extensive codification of securitisations was achieved through the Law of 22 March 2004 on Securitisation, with the latest and significant amendment being the Modifying Law of 25 February 2022 (henceforth: Securitisation Act).[220]

The Securitisation Act defines securitisation (*titrisation*) as a transaction by which a securitisation vehicle (*organisme de titrisation*) acquires or assumes, directly or through another vehicle, risks relating to claims, other assets, or obligations assumed by third parties or inherent to all or part of the activities of third parties and issues financial instruments (*instrument financier*) or contracts, for all or part of it, any type of loan, whose value or yield

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[217] For more information regarding the delay and its effects in practice see Milaković, G. (2017) Prestanak važenja odgode povjerenja u zemljišne knjige, Informator br. 6460. Available on-line at: https://informator.hr/strucni-clanci/prestanak-vazenja-odgode-povjerenja-u-zemljisne-knjige (Accessed: 31 July 2023)
[218] Deloitte (2018), p. 39.
[219] Commission de Surveillance du Secteur Financier, Newsletter No. 268, May 2023, p. 14. Available at: https://www.cssf.lu/wp-content/uploads/newsletter268.pdf (Accessed: 1 July 2023)
[220] Loi modifiée du 22 mars 2004 relative à la titrisation, Journal officiel, Mémorial A, 2004, No. 46, Grand-duché de Luxembourg. (henceforth: Securitisation Act)

depends on such risks.[221] The term securitisation vehicle coincides with the acronym SPE used before.[222] Akin to SECR, the Securitisation Act gives a broad definition which is somewhat constricted by a CSSF guideline on securitisation indicating that the main purpose of a securitisation transaction under the Securitisation Act must be an economic transformation of certain risks into securities and that the parties should comply with the legal definition of securitisation and the spirit of the law.[223] The financial instrument used in securitisations according to Art. 1(3) Securitisation Act are defined by the Financial Collateral Arrangements Act.[224] These include all securities (e.g. shares in companies or other equivalent securities, participations in companies, units in collective investment vehicles, bonds and other forms of debt instruments, certificates of deposit, loan notes, payment instruments, etc.), securities incorporating acquisition rights (by subscription, purchase or exchange), term financial instruments and instruments giving rise to a cash settlement (excluding instruments of payment), other instruments evidencing ownership rights, claim rights or securities, and other instruments related to financial underlyings, indices, commodities, precious metals, produce, metals or merchandise, other goods or risks.[225] In order to benefit from the Securitisation Act provisions, the SPEs must explicitly refer to the act in its articles of association or issuance documentation (*opt-in regime*), apart from being domiciled in Luxembourg.[226]

Luxembourg SPEs may be set up either as companies or as funds.[227] Securitisation companies can be set up as public limited companies (*société anonyme*), partnerships limited by shares (*société en commandite par actions*), private limited liability companies (*société à responsabilité limitée*), partnerships (*société en nom collectif*), limited partnerships (*société en commandite simple*), special limited partnerships (*société en commandite spéciale*), simplified joint stock companies (*société par actions simplifiée*), or cooperative societies organised as public limited companies (*société coopérative organisée comme une société anonyme*).[228] Securitisation funds, who do not have legal personality, may consist of one or several co-ownerships or fiduciary estates which is expressly stated in the management regulations of the

[221] Art. 1(1) Securitisation Act
[222] It is worth noticing that in art. 1(2) the Securitisation Act defines both single-tier and two-tier SPEs, the latter meaning that acquisition of risks and issuance of financial instruments are split between two entities, the acquisition vehicle, and the issuing vehicle.
[223] Zanev, V. and Taillefer, N. (2023), p. 3.
[224] Loi modifiée du 5 août 2005 sur les contrats de garantie financière, Journal officiel, Mémorial A, 2005, No. 128, Grand-duché de Luxembourg. (henceforth: Financial Collateral Arrangements Act)
[225] Art. 1(8) Financial Collateral Arrangements Act
[226] Arts. 1(2) and 3 Securitisation Act
[227] Art. 2 Securitisation Act
[228] Art. 4(1) Securitisation Act

fund.[229] It may also consist of several compartments corresponding to a distinct co-ownership or fiduciary estate each.[230] The management company of a securitisation fund must be a commercial company whose object is to manage securitisation funds and, as the case may be, to act as fiduciary of funds consisting of one or more fiduciary properties.[231] Liquid assets and securities of the SPE must be entrusted with a credit institution established or having its registered office in Luxembourg.[232]

All Luxembourg SPEs who issue financial instruments offered to the public on a continuous basis, meaning more than three distinct series[233] of issuances of financial instruments during one financial year, must be authorised by the CSSF thus becoming Authorised Securitisation Vehicles (*organismes de titrisation agréés*).[234] An issuance of financial instruments offered to the public indicates issuances not intended for professional clients, whose denominations are less than € 100.000, and which are not distributed as private placement.[235] In order to exercise their activities, the SPEs must be authorised by the CSSF which keeps a list of such vehicles.[236] The CSSF must also approve its articles of incorporation or the management regulations in order to authorise the vehicle.[237] The Securitisation Act then proceeds to regulate the CSSF's supervision competences, rights, and the decisions it may adopt in accordance with said law.[238] Chapter III of Title II regulates some aspects of voluntary and compulsory liquidation of both authorised and non-authorised securitisation vehicles, while Chapter IV codifies accounting, audit, and the tax regime applicable to securitisation vehicles.

Risks capable of being securitised include all those relating to the holding of assets, movable or immovable, tangible or intangible, as well as risks resulting from the obligations assumed by third parties.[239] With regard to the perfection of assignments of existing claims by securitisation vehicles, the Securitisation Act provides that those agreements become both effective between the parties of the agreement and opposable against third parties as from the

[229] Art. 6 (1-2) Securitisation Act
[230] Art. 8 Securitisation Act
[231] Art. 14(1) Securitisation Act
[232] Art. 22 Securitisation Act
[233] Commission de Surveillance du Secteur Financier (2013) Frequently Asked Questions, p. 4. Available on-line at: https://www.cssf.lu/wp-content/uploads/files/Titrisation/FAQ_titrisation_231013_eng.pdf (Accessed: 31 July 2023)
[234] Art. 19(1) Securitisation Act
[235] Art. 19(3) Securitisation Act
[236] Arts. 19(1) and 21(1) Securitisation Act
[237] Art. 20(1) Securitisation Act
[238] Arts. 23-31 Securitisation Act
[239] Art. 53(1) Securitisation Act

moment the assignment is agreed upon.[240] A future claim is capable of being assigned provided that it can be identified at the time it comes into existence or at the time agreed between the parties[241]. The assignment of future claims becomes both effective between the parties of the agreement and opposable against third parties as from the moment the assignment is agreed upon, provided that the claim has come into existence.[242] The assigned debtor is validly discharged from their obligations by payment to the assignor as long as it has not gained knowledge of the assignment.[243] If the assignment of a claim is prohibited by its original agreement, the assignment is not opposable against the assigned debtor. However, the assignment will be opposable to the debtor if they have either agreed to said assignment, the assignee legitimately ignored such non-compliance, or whenever the assignment relates to a pecuniary claim.[244]

The Securitisation Act contains private international law rules regarding assignation which provide that the law of the State in which the assignor is located governs the conditions under which the assignment is effective against third parties.[245] It is worth reminding that with regard to conflict-of-laws the application of the Rome I Regulation has priority between member states.[246] It is worth emphasising that most of the time foreign and not Luxembourg law will govern these legal acts, since most assets involved in Luxembourg based securitisations are located abroad.[247] Crucially, reassignment and claw-back provisions are excluded, with notable exceptions, regarding assets transferred to the SPE destined for securitisation ensuring bankruptcy remoteness.[248]

Title IV Chapter I of the Securitisation Act is aimed at resolving the legal position of investors and creditors. The rights of investors and creditors are limited to the assets of the securitisation vehicle, and where applicable to a specific compartment of the securitisation vehicle.[249] Financial instruments may be issued whose value or yield is linked to specific compartments, assets, or risks.[250] The Securitisation Act provides rules of subordination for financial

[240] Art. 55(1) Securitisation Act
[241] Art. 55(2) Securitisation Act
[242] Art. 55(3) Securitisation Act
[243] Art. 56(3) Securitisation Act
[244] Art. 57 Securitisation Act
[245] 58(2) Securitisation Act
[246] Regulation (EC) 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), ELI: http://data.europa.eu/eli/reg/2008/593/oj.
[247] Zanev, V. and Taillefer, N. (2023), p. 3-4.
[248] *Idem.*
[249] Art. 62(1) Securitisation Act
[250] Art. 63(1) Securitisation Act

instruments, derogable by agreement.[251] Units of a securitisation fund of shares, units or partnership interest of a securitisation company, shall be subordinated to other financial instruments issued loans contracted by this securitisation company.[252] The shares, units or partnership interest of a securitisation company shall be subordinated to beneficiary shares issued by this securitisation company.[253] The beneficiary shares issued by a securitisation company shall be subordinated to debt financial instruments issued and to loans contracted by this securitisation company.[254] The non-fixed income debt financial instruments issued by a securitisation vehicle shall be subordinated to debt financial instruments with a fixed rate issued by this securitisation vehicle.[255]

Chapter II gives an exhaustive framework as to the powers and competences of fiduciary-representatives which can be entrusted with the management the investors or creditors interests in the securitisation vehicle. The Securitisation act mandates that such fiduciary-representatives be authorised by the CSSF[256], which only applies if they have their registered office in Luxembourg.[257] Such authorisation can only be granted to stock companies having a share capital and own funds of at least € 125.000 cumulatively.[258] Some of the very stringent rules include the lapse of the authorisation for non-use[259] in an uninterrupted period of 12 months, the withdrawal of the authorisation if the conditions on which it was granted are no longer met, or it was obtained by means of false declarations.[260] The latter is subject to judicial review by the administrative court.[261]

A very contained Title V regarding sanctions provides two categories of infringements. One is the imposition of fines by CSSF to directors, managers and officers of authorised securitisation vehicles, fiduciary-representatives, or liquidators (voluntary liquidation), in the event these refuse to provide financial reports and other requested information aimed at resolving inconsistencies and irregularities.[262] The other sanction consists of imprisonment and/or fine

[251] Art. 64(2) Securitisation Act
[252] Art. 64(1) Securitisation Act
[253] *Idem.*
[254] *Idem.*
[255] *Idem.*
[256] Art. 79 Securitisation Act
[257] Art. 67 Securitisation Act
[258] Art. 80(1) Securitisation Act
[259] Neither the Securitisation Act nor documents by the CSSF offer an elucidation as to what constitutes non-use of such authorisation. However, by contextual interpretation the term "non-use" can be understood as the entity not availing itself of the rights such authorisation confers them thus bearing a meaning akin to "non-activation".
[260] Art. 84 Securitisation Act
[261] *Idem.*
[262] Art. 85 Securitisation Act

for carrying out issuances of financial instruments offered to the public on a continuing basis without the securitisation vehicle being registered on CSSF's list defined within this Act.[263] The amending provisions of the Securitisation act intervene by modifying the laws regulating the financial sector, trusts and fiduciary contracts, income tax, wealth tax, and establishing the CSSF.[264] In accordance with the maxim *tempus regit actum* (time rules events), the Securitisation Act applies only to securitisations set up after its entry into force, unless done so on a voluntary basis.[265]

ii. Law of 16 July 2019 implementing the Securitisation Regulation

Analogously to what was previously said about the SECR-EA in Croatia the Securitisation Regulation Implementation Act (henceforth: SECR-IA) contains provisions about prospectus publication exceptions, prospectus liability, powers and competences of the supervising authority, administrative measures and sanctions, and criminal sanctions.[266] The SECR-IA designates the supervisory competences in accordance with SECR to the CSSF.[267] Some of the broad powers bestowed upon the CSSF include the right to require the inclusion of complementary information in the prospectus, documentation regarding controlling and controlled entities, suspend or prohibit a public offer of securities, suspend or refuse the authorization of a prospectus, etc.[268] On-site inspections to be conducted by the CSSF are regulated by specific provisions laid out in Art. 9, while the institutional cooperation is further defined in Art. 10. Specific provisions regarding the publication of decisions by the CSSF on sanctions and penalties are found in Art 14. Decisions by the CSSF may be challenged before the administrative tribunal.[269]

[263] Art. 85-1 Securitisation Act
[264] Arts. 86-90 Securitisation Act
[265] Art. 91 Securitisation Act
[266] Loi du 16 juillet 2019 relative aux prospectus pour valeurs mobilières et portant mise en œuvre du règlement (UE) 2017/1129 du Parlement européen et du Conseil du 14 juin 2017 concernant le prospectus à publier en cas d'offre au public de valeurs mobilières ou en vue de l'admission de valeurs mobilières à la négociation sur un marché réglementé, et abrogeant la directive 2003/71/CE, Journal officiel, Mémorial A, 2019, No. 513, Grand-duché de Luxembourg. (henceforth: SECR-IA)
[267] Art. 6 SECR-IA
[268] Art. 7 SECR-IA
[269] Art. 15 SECR-IA

iii. Law of 10 August 1915 on Commercial Companies

A crucial structural act for securitisation SPEs set-up as companies is the Law of 10 August 1915 on commercial companies, as last amended by the Law of 6 August 2021 (henceforth: Companies Act).[270] It provides in detail the corporate structure, management, supervision, and compliance requirements for the corporate entities designated by the Securitisation Act. The two most commonly used corporate forms in practice are the public limited company (*société anonyme* or S.A.) and the private limited liability company (*société à responsabilité limitée* or S.à.r.l.).[271]

In cases where SPEs are set-up as securitisation funds, the fund does not have legal personality but consists of a fenced-off asset pool managed by a management company (*société de gestion*) which can be any commercial company whose object is to manage securitisation funds[272] and, as the case may be, to act as fiduciary of funds consisting of one or more fiduciary properties, as long as it's domiciled in Luxembourg.[273] Securitisation funds can be structured as fiduciary estates or as co-ownership of assets (*copropriété*), the latter entailing a right *in rem* to the underlying securitised assets held by investors. [274]

iv. Law of 8 December 2021 on the Issuance of Covered Bonds

The Covered Bonds Act, transposing the Covered Bonds Directive into Luxembourg law, covers the operating conditions and issue of covered bonds, additional conditions for the qualification as "European Covered Bond" or "European Covered Bond (Premium)", coverage requirements and pool, physical collateral assets, requirements for liquidity, extendable maturity structures, automatic acceleration of maturity, particular requirements for certain guarantees, intragroup pooled covered bond structures, obligations of an issuing credit institution in relation to the issue of covered bonds, supervision of covered bonds, and contains a number of amending provisions. [275] Unlike the former regime, the Covered Bonds Act allows standard banks to issue covered bonds without the need to obtain a specialised licence by the

[270] Loi modifiée du 10 août 1915, concernant les sociétés commerciales, Journal officiel, Mémorial A, 1915, No. 90, Grand-duché de Luxembourg. (henceforth: Companies Act)
[271] Zanev, V. and Taillefer, N. (2022) Luxembourg Securitisation Vehicles, Loyens & Loeff, p. 4.
[272] Art. 14(1) Securitisation Act
[273] For a better understanding of the competences of a Luxembourg management company *see* Elvinger, J. and Schmit, I. (2004) Les sociétés de gestion d'organismes de placement collectif en droit luxembourgeois, Droit bancaire et financier au Luxembourg, Larcier, vol. 4, pp. 1495-1537.
[274] Zanev, V. and Taillefer, N. (2022), p. 5.
[275] Loi du 8 décembre 2021 relative à l'émission de lettres de gage, Journal officiel, Mémorial A, 2021, No. 845, Grand-duché de Luxembourg. (henceforth: Covered Bonds Act)

CSSF.[276] In the context of securitisation the Covered Bonds Act gives more certainty as it regulates a very specific type of debt instrument which has an underlying asset pool covering for the principal and interest of the bond. A clear regime, which entails the severance of the assets from the liabilities of the issuer, is crucial for investor protection and financial market stability.

v. Taxation

The SPE will be subject to different taxation regimes depending on its structure. Luxembourg SPEs are subject to Corporate Income Tax (*impôt sur le revenu des collectivités*) if founded as capital companies (*sociétés de capitaux*)[277] whose rate varies from 15% to 17% based on the annual income. A surcharge of 7% is applied on said rate for the national employment fund (*majoration pour les fonds pour l'emploi*).[278] Finally a Municipal Business Tax (*impôt commercial communal*) is applicable with a rate of 6,75% for Luxembourg (city), 8,25% for Esch/Alzette and 9% for Troisvierges.[279] *Exempli gratia*, a Luxembourg (city) based SPE with more than € 200.000 annual revenue would be subject to an aggregate tax rate of 24.94%. An SPE benefits from a special tax treatment which makes commitments towards investors and creditors tax deductible, including profits available for distribution to shareholders.[280] However, interest expenses may be subject to deduction limitations as seen in the Croatian Capital Gains Tax Act, consequence of the implementation of the European Anti Tax-Avoidance Directive (also known as ATAD 1).[281] SPEs set up in the form of a fund are not subject to Luxembourg corporate taxation, but they would also not qualify for tax treaty benefits.[282] A securitisation company is subject to the minimum annual Net Wealth Tax (*impôt sur la fortune*)[283], which typically does not exceed € 4.815 since in most cases at least 90% of the SPE's assets are financial such as shares, loans, securities and cash.[284] Securitisation funds

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[276] Zanev, V. and Taillefer, N. (2023), p. 16.

[277] Art. 158 Loi modifiée du 4 décembre 1967 concernant l'impôt sur le revenu, Journal officiel, Mémorial A, 1967, No. 79, Grand-duché de Luxembourg.

[278] Art. 3(2) Loi du 12 mai 1987 portant création d'un fonds pour l'emploi, Journal officiel, Mémorial A, 1987, No. 37, Grand-duché de Luxembourg.

[279] Information for the fiscal year 2023 available on https://guichet.public.lu/fr/entreprises/fiscalite/impots-benefices/impots-divers/impot-commercial-communal.html#bloub-4. (Accessed: 7 July 2023)

[280] Zanev, V. and Taillefer, N. (2023), pp. 7-8.

[281] Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market. ELI: http://data.europa.eu/eli/dir/2016/1164/oj

[282] Zanev, V. and Taillefer, N. (2023), p. 8.

[283] Loi sur l'impôt sur la fortune du 16 octobre 1934 - Vermögenssteuergesetz (VStG) vom 16. Oktober 1934, Journal officiel, Mémorial A, 1934, No. 900, Grand-duché de Luxembourg, eingeführt durch die Verordnung vom 31 Dezember 1940 (V.Bl. Nr. 77, S. 476)

[284] Zanev, V. and Taillefer, N. (2023), p. 8.

are excluded from the scope of application of the VStG, thus not subject to such taxation.[285] Altogether, Luxembourg offers a favourable tributary regime for securitisations regardless of the location of the underlying assets since the crucial elements to the operation are deductible, at least that is the case for the most common securitisation companies since SPEs prevail over securitisation funds.

5. Legal Qualification of a Traditional Securitisation Transaction

When qualifying a true-sale securitisation transaction of receivables (credit) under traditional legal relations two theories have emerged. Under the dualist construct the transaction is divided in a first phase dedicated to the acquisition-transfer of securitised receivables between the Originator and the SPE through a purchase agreement and a second phase dedicated to the issuance of debt securities by the SPE to Investors whose yield is linked to the flow generated by the receivables now under the SPEs ownership.[286] However, according to the monist construct it is the investors (securities holders) who acquire ownership of the underlying receivables through one *sui generis* transaction while the assets are only formally held by the SPE as a segregated asset mass with it having no right to access or dispose of them *stricto sensu*.[287] The latter situation in which the title holder is not the economic beneficiary of the title is defined as dissociative phenomenon of asset transfer.[288] This legal relation which has the final effect of transferring the economic benefit relating to assets while being held by the another entity is best characterised as agency without representation[289], common in financial and banking transactions.[290] It can be seen as a complex legal cooperation, akin to brokerage, which aims at bringing together the Originator and the investors. It follows that the securities issued within the framework of a securitization operation incorporate in their entirety the ownership of a set of assets and that each of them represents the quality of an indirect co-owner in proportion to that same set (*pro quota*).[291]

Since the SPE must not only hold but service the receivables in order to maintain cash flow further to be distributed to investors, the corporate structure of the SPE best suitable for such

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285 *Idem.*
286 Carota, L. (2016), pp. 931-936.
287 *Op. cit.,* pp. 936-938.
288 *Idem.*
289 Terminology used in comparative legal systems is *mandato senza rappresentanza* in Italian and *povjerenstvo bez ovlaštenja* in Croatian.
290 Carota, L. (2016), pp. 936-938.
291 *Op. cit.,* p. 939.

task is a highly specialised capital company ideally with the possibility of compartmentalisation and funds segregation with legal effect in bankruptcy proceeding. As was said before, the most common securitisation companies in Luxembourg are the S.A. and S.à.r.l. On the other hand, Croatia is in dire need of crystallising it's SPE structural requirements. It could emulate the Luxembourgoise system and mandate the setting-up of SPEs as public limited companies (*dioničko društvo*) or private limited liability companies (*društvo s ograničenom dogovornošću*). Cosidering that credit institutions according to Croatian law must be set-up as PLCs[292], and since the concept of SPE resembles closely that of a management company for alternative investment funds (UAIF), which can be set up either as PLCs or LLCs[293], it is perhaps the latter to be taken into consideration as the target corporate structure for Croatian SPEs in the current legislative climate.

Finally, with regard to the issuing consortium which assists the subscription and issuance of securities (covered bonds) to investors it is best practice to avoid excessive and obvious corporate connection between the SPE and Originator (mother company - subordination, mutual share ownership, etc.) yet that is practically unattainable. The issuing SPE gives a double guarantee on the covered bonds since their yield is protected by the underlying receivables and all the assets of the SPE that are not compartmentalised for specific purposes.[294] The procedure consists of the composition of the prospectus, administrative approvals in the cases mentioned above, its publication and call for subscription, the payment of the nominal and issue of the debt security (covered bond) which is followed by public supervision by competent authorities.

[292] Art. 20(1) Credit Institutions Act
[293] Art. 10 AIF Act
[294] Carota, L. (2016), p. 964.

6. Conclusion

This thesis presents an in-depth exploration of securitisation, a financial mechanism that not only unlocks the inherent value of illiquid assets but also provides a platform for risk diversification and capital generation. These attributes have been particularly beneficial in mitigating the economic fallout of the recent crisis, where securitisation played a pivotal role in stabilising the financial markets and bolstering economic recovery in the European Union.

The legislative landscape governing securitisation is complex and multifaceted, necessitating a unified body of law to encapsulate its essential aspects. The European Union, with its unique capacity to regulate market operations, has been instrumental in shaping this legislative framework through regulations and directives. This thesis delves into the intricacies of this regulatory environment, highlighting its significance in the broader context of securitisation.

It also examines the various securitisation structures, including traditional, synthetic and whole-business securitisation. Synthetic securitisation, while achieving the same objectives as traditional securitisation, circumvents the need for asset transfers across jurisdictions while on the downside presenting challenges in conducting due diligence ascertaining the ultimate risk bearer. Whole-business securitisation, originating in the United Kingdom in the 1990s, has expanded to cover a wide range of sectors, demonstrating the versatility of securitisation as a financial tool.

In conclusion, securitisation, despite its complexities and the challenges it faced, has proven to be a resilient and effective financial operation. It demonstrated the economic potential of asset mobilisation, risk diversification, and overall contribution to economic recovery (particularly in the face of adverse market events such as the COVID-19 pandemic), as was offered by the above comprehensive representation of securitisation, shedding light on its benefits, potential risks, and the regulatory framework that governs it. The insights summarized by this work underscore the importance of securitisation in the financial world and its potential for future applications.

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Table of Figures

Summary

Securitisation is a topic most people have certainly experienced the effects of and even inadvertently spoken about, since it lies at the basis of the last financial crisis lingering behind even after almost two decades. Most scientific papers and theses on securitisation come from the field of economics or finances while rarely being object of debate by legal professionals. The idea behind the thesis was to give a thorough insight into the legal foundations of those transactions. Firstly, the reader is introduced to the functional aspect of the transaction where the parties, assets, structures, and history are explained. Secondly, all relevant sources of law referring to securitisation and its elements in the EU, Croatia and Luxembourg are explained. Finally, the two approaches are combined into an analysis of the legal aspects of the crucial phases of a traditional securitisation.

Key words: securitisation, asset mobilisation, risk management, issuance of asset-backed securities, complex financing operations.

Sažetak

Sekuritizacija je tema čije je učinke zasigurno većina ljudi osjetila, a možda neznajući spominjala budući da je povezana s posljednjom financijskom krizom čije posljedice ostaju i nakon gotovo dva desetljeća. Većina znanstvenih i diplomskih radova o sekuritizaciji dolazi iz područja ekonomije ili financija, dok je ona rijetko predmet rasprave među pravnim stručnjacima. Ideja iza ovog rada je pružiti temeljito razumijevanje pravnih osnova tih transakcija. Prvenstveno se čitatelj upoznaje s funkcionalnim aspektom transakcije u kojem se objašnjavaju subjekti, imovina, strukture i povijest. Zatim se analiziraju se svi relevantni pravni izvori koji se odnose na sekuritizaciju i njezine elemente u EU, Hrvatskoj i Luksemburgu. Naposljetku se oba pristupa sjedinjuju u analizi pravnih aspekata ključnih faza tradicionalne securitizacije.

Ključne riječi: sekuritizacija, mobilizacija imovine, upravljanje rizikom, izdavanje pokrivenih vrijednosnih papira, složene financijske operacije.