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# The Romanian Legal Framework for Mortgage Bonds and Mortgage Backed Securities

**Bucharest, 6 April 2006**

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A wooden signpost with two blank wooden signs is positioned on the right side of the slide. The signpost is made of weathered wood and has two horizontal signs attached to it. The background is a clear, bright blue sky. The text on the left is in a white, serif font.

# Overview Prerequisites to the secondary mortgage market

# Overview

## The legal framework for new financial instruments in Romania

Four laws that were very recently published (March 2006), are expected to have a significant impact on the Romanian banking and financial market in general and on the Romanian mortgage lending market in particular.

Amendments to the **Mortgage Lending Act** (Law No. 34/2006, published on 3 March 2006, amending Law 190/1999)

**Mortgage Banks Law** (Law No.33/2006, published on 3 March 2006)

**Securitisation Law** (Law 31/2006, published on 13 March 2006)

**Mortgage Bonds Law** (Law 32/2006, published on 23 March 2006)

The main legal framework for Romanian primary and secondary mortgage market

# Prerequisites to the secondary market

Origination rules. New players.

Upgrade of the origination rules (amendments to Mortgage Lending Act)

- Defining with increased accuracy the area of applicability of the Act
- Both Romanian and foreign persons can be mortgage loan beneficiaries
- Clarifications on mortgaging future properties
- Increased flexibility in property insurance related to mortgage lending
- Detailed regulation of assignments of mortgage loan portfolios
- Separate regulation of primary market from the secondary market

New players: mortgage banks (The Mortgage Banks Law )

# The Romanian legal framework for Mortgage Backed Securities



# The Romanian legal framework for MBS

## Securitisation of mortgage loans: the concept

### Definition of securitisation (in Romanian “*securitizare*”)

A financial operation whereby an **investment vehicle** purchases pecuniary claims (all accessory rights included) (“**assets**”), groups them in **pools** and issues **asset-backed securities**.

**Securitisation of mortgage loans:** a securitisation whereby the asset-backed securities (in this case, “mortgage backed securities”) are issued based on a pool of pecuniary claims arising out of mortgage loans (“mortgage backed claims”, in Romanian “*creante ipotecare*”).

# The Romanian legal framework for MBS

Key aspects under Romanian law: The pool of assets

- Securitisable assets: Any pecuniary claims can be securitisable assets provided that:
  - the claims are transferable
  - the claims were originated in full compliance with the law
  - the claims are free of any encumbrances prior to being pledged as collateral for a securitisation.
- Mortgage backed claims are expressly mentioned as securitisable assets (Article 2(2)(a) in the Securitisation Law).

# The Romanian legal framework for MBS

## Key aspects under Romanian law: The pool of assets

- Transfer of mortgage loan portfolios

### Who can purchase mortgage loans?

- Originators: universal and mortgage banks, NHA, mortgage lending companies
- Other entities: SPVs established under the Securitisation Law

### Publicity and enforcement of assignment

- Versus third parties: Electronic Archive
- Versus borrowers: no “*silent assignment*”

### Post-assignment servicing

- Can be structured contractually
- If not structured contractually, done by the transferor



# The Romanian legal framework for MBS

Key aspects under Romanian law: The pool of assets

## Key legal issue

SPV's unchallenged ownership of collateral (asset pool)  
– the *true sale*

- Special protection for assignments to an SPV:
  - Limited duration for challenging the validity of an assignment of mortgage loans if assigned to an SPV
  - Not subject to insolvency claw-back

# The Romanian legal framework for MBS

Key aspects under Romanian law: the investment vehicle (SPV)

## Definition of the investment vehicle (in Romanian “*vehicul investitional*”)

An entity with or without legal personality having as **exclusive** object of activity the issuance of **asset-backed securities** on the basis of a **pool** of receivables

- Types of SPVs under Romanian law:
  - **Securitisation company** (has legal personality, issues MBB, pay-trough” structure, multiple securitisations vehicle)
  - **Securitisation fund** (civil partnership contract, issues MBU, “pass-through” structure, one securitisation only)
- Key features of SPVs
  - may only engage in activities necessary in order to effect the securitisation
  - has no employees; SPV’s operations are undertaken by specialised providers
  - is subject to legal restrictions

# The Romanian legal framework for MBS

Key aspects under Romanian law: the investment vehicle (SPV)

## Key legal issue

### SPV's bankruptcy's remoteness

- “Limited purpose concept”
- Aiming for management and operational independence from the Originator:
  - corporate servicing: done by SPV administrator
  - pool servicing and payment agent function: done by Portfolio Management Company. Special termination provisions when PMC is the transferor
- Creation of charges on the pool other than for MBS holders is void
- Isolation of the cover pool from SPV's bankrupt estate

# The Romanian legal framework for MBS

## Key aspects under Romanian law: the SPV Administrator

- The corporate servicer (“SPV administrator”):
  - Specialised service provider (joint stock company) subject to CNVM supervision;
  - Min. share capital €125,000; at least two shareholders are credit or financial institutions
- Services which cannot be delegated to third parties
  - Represents the SPV in the purchase of the assets and the MBS issue;
  - Reports to the Securities Commission and to the Agent
- Services which can be delegated to third parties
  - Provide administrative activities to the SPV;
  - Maintain the note-holders register
  - Structures the portfolio
  - Registers and publicize the cover pool security interest (when an Agent has not been appointed);
  - Represents the SPV versus third parties;

# **The Romanian legal framework for MBS**

Key aspects under Romanian law: servicer and paying agent (the PMC)

- The servicer: Portfolio Management Company (“PMC”)
  - Specialised service provider (either a credit or financial institution)
  - Manages the cash collection and foreclosure issues
  - Monitors the performance of the portfolio
  - Responsible for making payments on the securities to the investors
  - Must isolate each portfolio managed

# The Romanian legal framework for MBS

Key aspects under Romanian law: the Agent

## Definition of the agent

A legal person/entity without legal personality, representing the ABS/MB holders

- Agent and Trustee: interchangeable concepts?
  - Common law legal concept approach: not appropriate to use the word “trustee” for the Agent.
  - European securitisation best practices approach : the agent, as defined under Romanian law, fulfills the functions specific to the trustee.

# The Romanian legal framework for MBS

## Key aspects under Romanian law: the Agent

- Agent's main duties (defined in the Securitisation law by reference to the Mortgage Bonds Law)
  - Compliance check
  - Representation of the note holders
  - Notification to NSC and NBR of breach of the issuer's obligations
- Appointment & revocation
  - Mandatory for mortgage bonds
  - Optional for securitisations
- Who can act as agent?
  - Audit firms
  - Credit institutions and financial investment services companies
  - Lawyers and notaries

# The Romanian legal framework for MBS

## Key aspects under Romanian law: issuing MBS

- SPV Securitisation company – issues mortgage-backed bonds  
SPV Securitisation fund – issues mortgage-backed units
- Public offering regulated under Romanian Capital Market Law
- Minimal content of the Prospectus required by law:
  - Definition of Originator, Administrator, Servicer, Agent and Auditor
  - Definition of the main characteristics of the issue:
  - Definition of the portfolio securitized;
  - Definition of proceeds and financial investments of the SPV



# The Romanian legal framework for MBS

Key aspects under Romanian law: issuing MBS

## Key legal issue

### Investors' interest in the collateral

- First rank guarantee in favor of holders of mortgage backed securities
- Limited duration for challenging the security interest over the asset pool
- Not subject to insolvency claw-back.
- Over-collateralisation - not mandatory, however financial equilibrium is required by law

# The Romanian legal framework for MBS

## Key aspects under Romanian law: issuing MBS

### Options for the portfolio management

- Maintenance of the portfolio

The issuer may undertake through the prospectus the obligation to supplement the asset pool in the event the total value of the receivables included in the asset pool diminishes throughout the duration of the issue.

- Actively managed portfolios

The issuer may include in the asset pool own receivables such as cash collateral and other financial instruments to enhance the value of the pool or compensate decreases.

# The Romanian legal framework for Mortgage Bonds



# The Romanian legal framework for mortgage bonds

The concept. The limited use of mortgage bonds versus MBS

## Definition of Mortgage Bonds

Securities issued for the purpose of refinancing the mortgage lending activity of the issuer, based on a **cover pool** of mortgage loans over which the investors are granted a **first rank security interest** and a preference right against any other creditors of the issuer.

- Mortgage backed securities: financial instruments accessible to all the mortgage loan originators
- Mortgage bonds: financial instruments accessible only to banks
  - universal banks
  - specialised banks: mortgage banks (under the Mortgage Banks Law)

# The Romanian legal framework for mortgage bonds

## Key aspects under Romanian law: cover pool structuring principles

- Origination in compliance with applicable laws;
- Mortgage loans must be financing real estate in Romania or EU/ EEC
- Homogenous pools
- Weighted average of the maturities of the mortgage loans in the cover pool  $\geq$  the maturity of the mortgage bonds secured by such cover pool
- Updated value of claims securing an issue of mortgage bonds  $\geq$  the updated value of the payment obligations to mortgage bonds holders
- Aggregated value of the mortgage loans secured with mortgages over lands without constructions and of loan secured with mortgages over buildings in process  $\leq$  20% portfolio value
- Each mortgage loan in the cover meets the **general eligibility criteria** and the performing criteria established in the prospectus.

# The Romanian legal framework for mortgage bonds

## Key aspects under Romanian law: Cover pool general eligibility criteria

- The nominal value of a mortgage loan must be:
  - $\leq 80\%$  of reference value (residential mortgages)
  - $\leq 70\%$  of the reference value (commercial mortgage)
- Full disbursement of the principal
- Limited exposure per borrower (max 10% the value of the cover pool)
- The mortgage-backed claims in the pool are free of encumbrances
- Timely payments of the mortgage loans; max delay period (61 days).
- Minimum insurance threshold
- First rank mortgage established in favor of the issuer
- Additional eligibility criteria may be set by the issuers.

# The Romanian legal framework for mortgage bonds

Key aspects under Romanian law: The cover pool management

Cover pool's quality maintenance:

- Replacement of cover pool assets:
  - Mortgage loans in breach of the eligibility criteria
  - Non-performing loans (as defined in the law)
  - Mortgage loans causing decrease of cover pool value
- Eligible assets for replacement purposes
  - The assets must be replaced with other eligible mortgage loans
  - Limited use of other assets (yet to be regulated by Central Bank)

# The Romanian legal framework for mortgage bonds

## Key aspects under Romanian law: Issuing mortgage bonds

- Public offering as regulated under Romanian Capital Market Law
- Minimal content of the Prospectus required by law:
  - Definition of the Originator, Agent and Auditors;
  - Definition of the main characteristics of the issue:
    - Total value, nominal value, issue price of the MB;
    - Purchase price of the portfolio;
    - Duration, interests, reimbursement, buy – back.
    - The market where the MB are to be listed
    - Costs and expenses;
    - Etc.
  - Definition of the cover pool



# The Romanian legal framework for mortgage bonds

## Key aspects under Romanian law: Issuing mortgage bonds

### Key legal issue

### Investors' interest in the cover pool

- First rank guarantee for the MB holders
- The Agent (mandatory for mortgage bonds) guarantees execution and registration of the security interest
- Detailed rules for registration of security interest in Electronic Archive
- Changes of mortgages registrations need Electronic Archive's prior clearance
- Assignment/encumbrances of the cover-pool outside prospectus - void by law
- Over-collateralisation not mandatory, however financial equilibrium required
- Portfolio quality maintenance requirements

# The Romanian legal framework for mortgage bonds

Key aspects under Romanian law: Issuing mortgage bonds

**Key legal  
issue**

**“Bankruptcy remoteness”**

The Mortgage Bonds Law derogates from bankruptcy laws

- Isolation of the cover pool from the bankrupt estate
- In case of issuer’s bankruptcy, the cover pool is managed by a PMC
- Completion of the bankruptcy procedure does not trigger completion of the cover pools administration if any outstanding obligations to the bondholders

# The Regulators



# Regulators of the Romanian secondary mortgage market

Key competencies: mortgage backed securities

- Romanian Securities Commission (“CNVM”).
  - Regulate minimal contents of the prospectus and authorise public offer
  - Authorise SPV’s, PMCs (financial institutions) and SPV administrators
  - Collects current and periodical reports from the PMC and SPV administrator
  - Authorise and monitors the agents in conjunction with NBR
- Central Bank of Romania (“NBR”)
  - Authorise PMC (credit institutions)
  - Authorise and monitor the agents in conjunction with CNVM

# Regulators of the Romanian secondary mortgage market

Key competencies: mortgage bonds

- Romanian Securities Commission (“CNVM”)
  - Regulate minimal content of the prospectus and authorise MB public offer
  - Authorize PMCs (financial institutions)
  - Sets minimal contents of the current reports made by the issuer in case of substitution/supplementing the cover pool
  - Monitors the fulfillment of mortgage bonds issuer’s obligations
  - Authorise and monitor in conjunction with NBR the agents
- Central Bank of Romania(“NBR”)
  - Authorise PMC (credit institutions)
  - Authorise and monitor the agents in conjunction with CNVM
  - Regulate eligible assets for cover pool replacement purposes

# Romanian secondary mortgage market

What remains to be done?

- CNVM & NBR regulations
  - For mortgage banks: due by 2 July 2006
  - For securitisation: due by 12 July 2006
  - For mortgage bonds: due by 22 July 2006
- Tax issues
  - The need for tax certainty: tax legislation must be updated to specifically cover the fiscal regime applicable to the parties and transactions involved
- Accounting issues
  - Accounting standards must be harmonised in order to cover the entities involved in a securitisation transaction and thus mitigate possible divergent interpretations of the accounting regime applicable in a securitisation transaction
- And...

# The first Romanian MB/MBS issue!



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