

# At a glance

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## Residential Mortgage Backed Securitisation in Romania: Some Legal Issues

### Overview

It is likely that due to its large population and the outstanding growth of residential mortgage lending during the last few years, Romania will experience its first securitisation transactions of residential mortgage loans this year.

The following factors might support the Romanian banks entering into residential mortgage backed securitisation (RMBS) transactions: (i) existing lending caps, (ii) accession to the European Union and implementation of legislation related to securitisation, e.g. Capital Requirement Directive, Prospectuses Directive, Financial Collateral Directive etc., (iii) relatively favourable legal and tax environment, and (iv) the banks' aim to refinance with foreign capital markets.

### Legal considerations

Romania is among the few European Union member states with an established special securitisation framework. A special securitisation law (Law No. 31/2006) (the "Securitisation Law") was adopted in Romania in 2006 to expressly (i) allow local law true sale securitisations and (ii) regulate the bankruptcy remoteness of the Special Purpose Vehicle (SPV) incorporated in accordance with the Securitisation Law.

However, due to a number of legal uncertainties and formalities with this new legal framework, including (a) high minimum capital requirements for the SPV, (b) licensing of the SPV's administrator, (c) uncertainty with respect to the incorporation of local SPVs established pursuant to the Securitisation Law into cross-border securitisation transactions, (d) the notification requirement of the originating bank's creditors, and (e) the lack of tax relief for the SPV found in other jurisdictions in the region, it can be argued that off-shore securitisation relying on general civil law rather than on-shore securitisation will drive the market in Romania.

Thus, this paper essentially outlines the legal issues arising when structuring off-shore securitisations. References as to securitisation using the Securitisation Law are given for the purpose of better understanding of the structuring alternatives.

### (1) Choice of law

Until recently, the parties to an assignment agreement were free to choose foreign law to govern the sale and assignment or receivables only if a "foreign element" was involved in the contractual relationship. As of 1 January 2007 the Rome Convention On The Law Applicable To Contractual Obligations came into force for Romania. As a result, it should be now possible for Romanian parties to choose foreign law to govern the contractual relationship between the parties even if no "foreign element" is present. Notwithstanding the choice of foreign law to govern the contractual relationship between the parties, the agreement would remain subject to certain limitations that are required pursuant to Romanian law.

Hence, one can assume that provisions of the Romanian substantive law protecting obligors' rights, e.g. rights of set-off, perfection of the sale of receivables, must be considered when foreign law is selected to govern the assignment agreement.

Furthermore, to the extent Romanian real estate is concerned, residential mortgage loan agreements entered into between a Romanian originating bank and residents of Romania will be governed by Romanian law, e.g. Law On Mortgage Loans (Law No. 190/1999) or Law On Security Over Real Estate (Law No. 99/1999).

### (2) True sale of mortgage loans and mortgage collateral

Pursuant to Romanian law, an assignment of receivables is valid upon the agreement of the assignor and the assignee. It is preferable that the agreement is in writing, as in the case of the assignment of a mortgage loan such as an assignment of an insurance contract guaranteeing the respective mortgage. In both cases of an assignment of residential mortgage loans and residential mortgage insurance agreements the respective assignment agreement shall be registered with the Electronic Archive of Security over Movable Property and notice given to the borrower and the insurance company, as the case may be.

In addition, in off-shore transactions which cannot rely on the Securitisation Law, the transfer of the mortgage loan shall be registered with the respective land registry according to location

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of the respective mortgage property. There is no centralised land registry practice in Romania yet. However, the registration procedure is not cumbersome or even expensive. For example, registration of the respective mortgage title can be obtained within approx. 2 (two) weeks of filing for re-registration, whereby the costs of a single mortgage re-registration application are capped at approx. 15 (fifteen) Euro. In this context, by virtue of law, the re-registration is required for the purpose of perfection of the title over the mortgage in favour of the assignee, i.e. it is not a *conditio sine qua non* for validation of the assignment of the mortgage loan.

Under Romanian law, where a contractual prohibition on assignment is contained within an underlying contract, the purported assignment will be ineffective against third parties unless the borrower has expressly given its consent. Nevertheless, the general rule is that if Romanian law governs the assignment agreement, prior consent of the borrower is not necessary for validation of the assignment. However, if the borrower is notified of the assignment, as of the day of notification its rights to discharge or set-off against the originator will be cut off. The notification can be given either by the assignor or the assignee.

According to Romanian legislation, there are special provisions regarding the notification of assignment of mortgage-backed loans. Thus, pursuant to Law No. 190/1999 regarding real estate investments, the borrower must be notified by a registered letter either by the assignor or by the assignee. If it has not been agreed that the assignee will notify, the notification to the borrower shall be given by the assignor within 10 (ten) days from the execution of the assignment. However, Romanian law does not provide any penalty if notice is given later. In case of transfer of an entire portfolio of mortgage loans and respective collateral, the registration may be ensured by means of a global notice to the Electronic Archive of Security over Movable Property.

In summary, a transfer of a mortgage loan along with the ancillary right over the mortgage shall be construed in way that a true sale can only be achieved when the assignment agreement is valid and appropriately registered, the borrower is notified and the transaction is concluded "at arm's length" (see also below section (3)).

### **(3) Claw-back and "suspect periods"**

Under Romanian civil law, preferential or fraudulent transactions as well as transactions at an undervalue may be challenged by the assignor's creditors within three years from the date of registration with the Electronic Archive for Security Interests in Movable Property (Art. 975 Civil Code).

In addition, the insolvency administrator may challenge fraudulent transactions concluded within a general "suspect period" of three years prior to the commencement of insolvency proceedings in respect of the assignor. A special "suspect period" of 120 days is applicable with regard to certain dispositions of the assignor's property, e.g. transferring property in order to discharge debt, granting security in real estate etc. Further, where transactions are concluded between affiliated companies, a "suspect period" of

only one year is applicable. An insolvency law enacted last year (Law No. 85/2006) follows the previous insolvency law (Law No. 64/1995) in terms of "suspect periods" and provides for the same general three-year "suspect period" for fraudulent transactions.

In comparison, SPVs established according to the provisions of the Securitisation Law benefit from the explicit exemption from the above restrictions set out by Romanian insolvency law.

"Non-petition" clauses are not yet a proven mechanism for enhancing credit worthiness of securitisation transactions in Romania, but the clauses themselves are effective and valid if agreed upon between the parties.

### **(4) Data protection**

Pursuant to Romanian data protection legislation (Law No. 677/2001), an originator is entitled to disclose information regarding the underlying receivable to the SPV or to any other party related to the transaction, provided that (i) the borrower's consent (also with the respective mortgage loan agreement) is obtained and (ii) the Data Protection Ombudsman (the "Ombudsman") is notified. Further, the "export" of personal data shall be ever notified to the Ombudsman.

In terms of banking secrecy under Romanian law, it may be assumed that banking secrecy rules are deemed to be complied with to the extent that the disclosure of the debt (receivables contract) and related information does not infringe rules regarding disclosure of information concerning the borrower's deposits and account movements. This is the case where the borrower has given its consent to the disclosure. Nevertheless, special attention has to be given to the respective provisions of the Romanian Banking Law (Emergency Ordinance No. 99/2006) regarding banking secrecy when structuring an RMBS transaction.

### **(5) Regulatory**

Under Romanian law, the business activity of purchasing mortgage loans is free from licensing requirements. Servicing may only be performed by credit institutions or financial institutions authorised by the Romanian National Bank.

There are no restrictions on money transfer and currency exchange in Romania, however, some declaration obligations exist, for example, stating the purpose of the money transfer.

Pursuant to Regulation No. 21/26/2006 regarding the treatment of the credit risk associated with securitisations (the "Securitisation Regulation"), Romanian law has incorporated the securitisation part of the Capital Requirement Directive. Accordingly, under Romanian law, exposures with respect to traditional (true sale) as well as synthetic securitisation are specifically treated and risk weightings applied. For instance, in a true sale securitisation a Romanian originator may exclude from its risk exposure those exposures which are securitised by way of transfer of "significant credit risk".

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## (6) Taxation

Some of the double tax treaties in force for Romania allow minimisation of the withholding tax duty to zero (e.g. with The Netherlands), provided that certain procedures are complied with, such as delivery of a certificate of residency by the foreign tax resident.

Under Romanian tax law, there is no stamp duty on the sale of receivables other than a fee with regard to the re-registration of the mortgage assignment on the name of the SPV.

Under Romanian tax law, the transfer of receivables is a VAT exempted transaction.

The servicing of receivables triggers VAT under Romanian law to the extent it is performed within Romania.

## Contact

Dr. Ralf Hesdahl, rhesdahl@mayerbrownrowe.com  
Dr. Jörg Wulfken, jwulfken@mayerbrownrowe.com  
**Frankfurt/Main:** Mayer, Brown, Rowe & Maw LLP  
Bockenheimer Landstrasse 98-100, 60323 Frankfurt am Main  
Tel.: +49 (0)69 79 41 0, Fax: +49 (0)69 79 41 100

Bruce Bloomingdale, bbloomingdale@mayerbrownrowe.com  
Dominic Griffiths, dgriffiths@mayerbrownrowe.com  
**London:** Mayer, Brown, Rowe & Maw LLP  
11 Pilgrim Street, London EC4V 6RW  
Tel.: +44 (0)20 7248 4282, Fax: +44 (0)20 7248 2009

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