

## AT A GLANCE

SEPTEMBER 2007

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### SECURITISATION IN GEORGIA: SOME LEGAL ISSUES

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#### OVERVIEW

In spite of its small population compared with other Eastern European countries, Georgia is a fast-growing market economy with substantial potential. The favorable Georgian banking environment and the significant growth of the country's mortgage and consumer loan markets will support banks entering into securitization transactions.

#### LEGAL CONSIDERATIONS

Due to the lack of a proven track record for securitization transactions in Georgia, previous experience gained in other Eastern and Central European countries in cross-border contractual arrangements might influence the first securitization deals.

A distinctive feature of Georgian law is the fact that civil activity of the government and government agencies is regulated by the same provisions that apply to legal entities. Thus, assignment under contract concluded with the government and government agencies shall comply with the general requirements as to the form of such assignment and that assignment shall be treated as a commercial rather than a public act.

#### (1) CHOICE OF LAW

Under Georgian law, parties to a contract are free to choose the law which will govern their contractual relationship, e.g. the law of either of the parties or the law of a third state. However, following the provisions of the Rome Convention which is implemented into Georgian law, the choice of foreign law is subject to statutory reservations relating to public policy and mandatory rules from which the parties cannot derogate (Section 5 and 6 of the International Private Law Act).

In the absence of contractual choice, the contract will be governed by the law of the country with which it is most closely connected. This will usually be the country where the assignor – the party who is to effect the performance which is characteristic of the contract, has its principal place of business (Section 36 of the International Private Law Act).

Where a foreign-based special purpose vehicle (SPV) purchases receivables from a Georgian originator, notwithstanding that the assignment agreement may be governed by foreign law, legal issues relating to the underlying receivables such as assignability, discharge and set-off by a debtor (the underlying obligor in a securitization deal) or the relationship between the assignee and the debtor will continue to be determined in accordance with Georgian law.

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(2) TRUE SALE

Under the law of Georgia an assignment agreement is valid when the assignor (the originator in a securitization transaction) and the assignee (the purchaser or SPV in a securitization transaction) agree to its terms, unless the underlying receivables contract or statutory provisions prohibit assignment. There is no special form for the sale and assignment of receivables under Georgian law; thus, the parties can agree both orally or in writing. In every case the assigned receivables must be sufficiently identified in the assignment agreement.

When Georgian law governs the assignment agreement between an assignor and an assignee, no consent of a debtor (the underlying obligor in a securitization transaction) is required for a valid assignment. In addition, no notification of the debtors is needed for the perfection of the assignment.

It should be noted, however, that unless the debtor is notified of the assignment, it remains entitled to discharge its obligations by paying the assignor, despite the fact that the legal owner of the receivables will be the assignee. On the other hand, if the debtor is duly notified the debtor will not be entitled to set-off or counterclaim of those obligations which arose following the notification of the assignor's obligations. Either the assignor or the assignee may notify the debtor of the assignment.

Under Georgian law, a special rule governs the assignment agreement when the assigned receivables are secured by a mortgage. In such case the transfer of the mortgage by the means of both a re-registration and an execution of a written mortgage agreement to the assignee is required for the assignment to be valid.

(3) TRANSFER OF COLLATERAL

Ancillary rights, such as mortgages and pledges, are transferred to the assignee automatically with the assignment of the underlying receivables, provided that they are related to the assigned receivables. Nevertheless, depending on the nature of the security, consideration needs to be given to the re-registration of the collateral.

To validly transfer mortgage rights, for example, the parties have to comply with the re-registration procedures set out above.

According to Georgian law, a pledge could be either registered (non-possessory) or non-registered (possessory). When the assigned receivables contract is backed by a non-registered pledge, the assignee should demand transfer of movable pledge assets or registration, otherwise such pledge right will cease to exist. On the other hand, where a pledge right relating to the assigned receivables has been registered on the public register of proprietary rights, including security interest rights over movables, the assignee as new creditor needs to register his right to the collateral for the assigned assets in order to become new pledgee, as well as for evidence and enforcement purposes.

(4) CLAW-BACK AND "SUSPECT PERIODS"

An insolvency administrator in Georgia is entitled to challenge transactions in the circumstances provided under Georgian insolvency legislation in the following cases:

- (i) the assignor intended to prejudice the creditor and the third party (assignee) was aware of this intention (fraudulent transactions);
- (ii) the assignment was concluded in favor of the interested party (assignee) one year prior to the insolvency of the assignor and the assignor intended to defraud its creditors, provided the assignee is unable to prove that he did not know at the time of the assignment that the assignor had such intention (intra-group transactions);

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(iii) the transaction concluded one year prior to the commencement of insolvency proceedings and the assignor intended to transfer assets free of cost (not “at arms length”). If the transferee is an interested party than “suspect period” is lengthened to three years; and

(iv) the assignment was concluded after the assignor’s obligation to pay had ended or after sending the letter of commencing insolvency proceedings and the assignee at the time of assignment knew or should have known the insolvency of the assignor or the fact of filing an application on insolvency proceedings.

Where the assignor is a bank or other credit organization, a temporary insolvency administrator or liquidator shall have the power to challenge any action or transaction by an administrator of the bank entered into during a period of one year before the appointment of the temporary administrator or liquidator by applying to a court. In addition, the temporary administrator or liquidator may demand voiding any such transaction if persons related to the bank benefited at the expense of the bank, or took advantage and abused privileges which caused damages to the bank (its creditors).

Under Georgian law, the period of time during which to make use of the right to claw-back is three years (measured from the commencement of insolvency proceedings) for banks as well as other entities.

(5) DATA PROTECTION

There is no special consumer data protection legislation in Georgia. However, several types of confidential data are protected under Georgian law, including, commercial secrets, professional secrets, tax secrets and personal data.

However, upon an assignment the Georgian Civil Code requires that the assignor provides all relevant documents and information to enable the assignee to exercise his rights with respect to the assigned receivables. Consequently it must also be possible to disclose a certain amount of important information.

According to Article 17 of the Georgian Law on Activities of Commercial Banks, no one is entitled to allow third parties access to confidential information, to disclose and extend such information, or to use it for private purposes. Banks are limited by strict banking secrecy rules, but only concerning information about bank accounts, its operations and balances; obtaining such information is possible only by court decision. Hence, the debtor’s data is not subject to bank secrecy rules.

(6) REGULATORY

Under Georgian law the purchasing and servicing of receivables are business activities free of licensing requirements. Foreign banks may provide cross-border lending or receivables purchasing activities in Georgia without being licensed by the Georgian National Bank.

There are also no restrictions on money transfer (except for certain declaration obligation) and currency exchange in Georgia except of certain requirements under anti-money laundering rules. No particular regulatory obstacles exist for Georgian counterparties when they participate in cross-border transactions.

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#### (7) TAXATION

Pursuant to Georgian tax legislation, no VAT should be levied on the transfer of receivables. The double tax treaties with certain jurisdictions, e.g. Belgium, Germany and The Netherlands, might allow a reduction of the withholding tax on interest to zero, provided certain procedural requirements are met.

Repayment of principal is not subject to withholding tax. Withholding tax at the rate of 10 % is applied to interest payments to a non-resident, unless a double tax treaty of Georgia provides otherwise.

The servicing of receivables triggers VAT under Georgian law to the extent such servicing is performed within Georgia.

According to Georgian tax law, there are no stamp duties or other taxes or fees when assigning receivables, although fees may be payable in respect of the re-registration of related collateral. For example, mortgages must be registered and registration fees paid with regard to the registration of the new assignee's rights in the public registry.

In any case, it is recommended to obtain a tax-related opinion from local counsel.

For inquiries related to this publication, please contact one of the authors:

#### **Frankfurt**

##### **Dr. Ralf Hesdahl**

rhesdahl@mayerbrown.com

##### **Dr. Jörg Wulfken**

jwulfken@mayerbrown.com

Mayer Brown LLP

Bockenheimer Landstrasse 98-100

60323 Frankfurt am Main

T: +49 69 79 41 0

F: +49 69 79 41 100

#### **London**

##### **Bruce Bloomingdale**

bbloomingdale@mayerbrown.com

##### **Dominic Griffiths**

dgriffiths@mayerbrown.com

Mayer Brown International LLP

11 Pilgrim Street, London EC4V 6RW

T: +44 20 7248 4282

F: +44 20 7248 2009

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