General overview of a typical Dutch true sale securitisation – May 2015[1]

1. INTRODUCTION

In the mid-1990s the first Dutch public securitisation transactions came alive. Since then, the Netherlands has become one of the markets in Europe where the highest volume of residential mortgage-backed securities (RMBS) transactions take place.

In structuring securitisation transactions a number of credit, legal, tax and regulatory issues must be taken into consideration. The choice of a particular securitisation transaction structure is primarily dependent on the reasons for setting up the transaction.

In recent years, a number of initiatives by international and local governments, organisations and regulatory authorities have been and/or are in the process of being developed in response to the market turmoil. Taking into account such market turmoil (and the role that structured products have played therein) and the resulting (anticipated) regulatory changes, the landscape of securitisation has changed – and is expected to change further and rapidly – in both Europe and the U.S. Although securitisation techniques have shown to be useful tools to mitigate or eliminate credit risk, it remains to be seen what impact such regulatory changes will have on the market for securitised products.

The main intention of this note is to give a general overview of a typical Dutch true sale residential mortgage-backed securitisation (Dutch RMBS) structure and related issues, main participants and their respective roles in such transaction.[2]

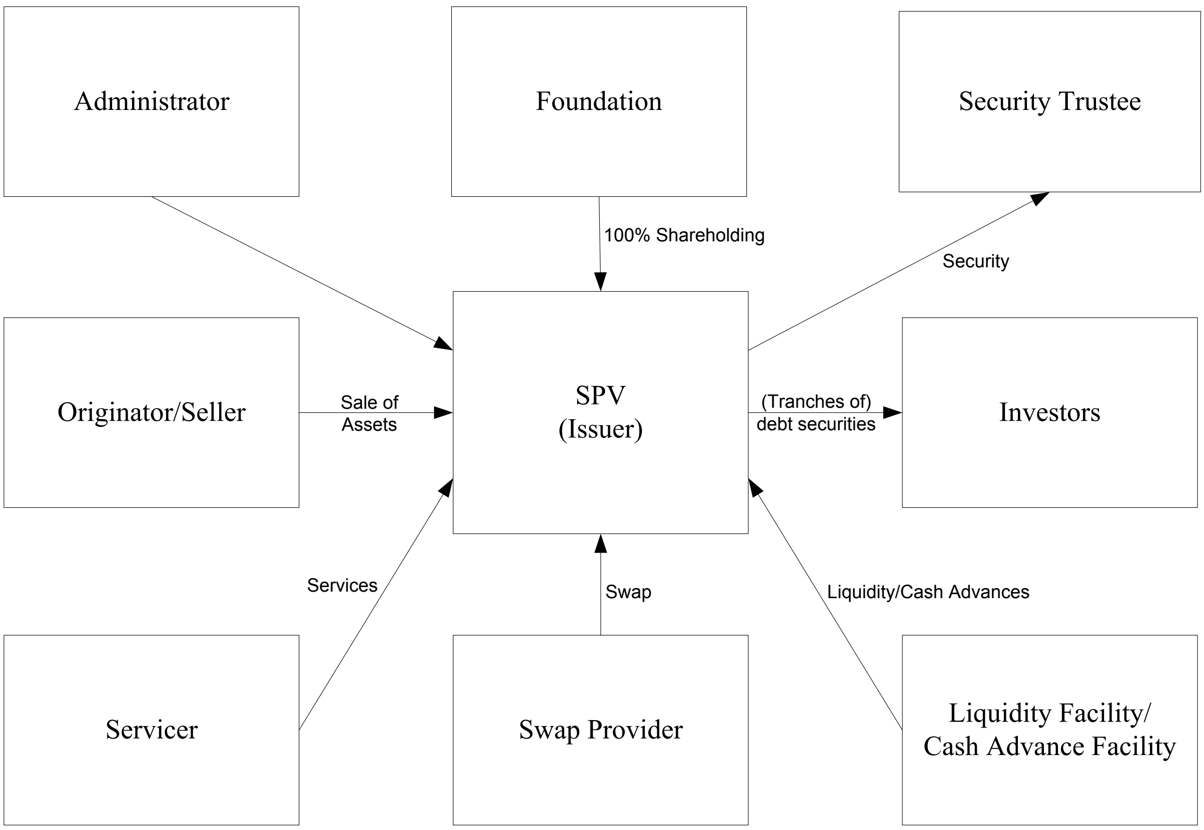
Except for the matters specifically mentioned in this note, it does not address Dutch, European or U.S. mandatory requirements (including, without limitation, those pursuant to CRR, AIFMR, CRAIII or the ECB Regulation) [3] relating to risk retention, disclosure on the securitisation or securitised assets, due diligence, application or maintenance of structured credit ratings in respect of exposures or requirements relating to eligibility for Eurosystem (or other) credit operations which may apply to certain institutions (including banks, insurers and investment funds and managers) involved in Dutch RMBS. It does also not deal with the application of standards and practices of Dutch and European industry bodies and associations, including the Dutch Securitisation Association and the Prime Collateralised Securities Association, that may apply to Dutch RMBS. [4]

2. TRUE SALE TRANSACTION

Securitisation can be described as a financing transaction whereby certain identified cash flows are applied to repay debt financing that has been attracted by, typically, a special purpose vehicle (SPV), through the issuance of debt securities. Recourse of the creditors of the SPV is limited to these cash flows and the assets that generate these cash flows.

A true sale transaction is the traditional form of securitisation. An SPV acquires receivables or other assets from one or more sellers (which are often but not necessarily the originator of the assets) and pays a purchase price for these receivables. The 'true sale' element means that the assets are transferred by the seller to the SPV and, as a result of which, the SPV becomes entitled to the cash flows that are generated by the assets (including those resulting from a subsequent sale of the assets). The legal arrangements should ensure that, in the event of insolvency of the seller, the cash flows remain the property of the SPV and, therefore, that the seller's creditors cannot challenge the validity of the transfer. This is typically achieved through an effective legal transfer of the assets or a perfected security interest created over such assets. The SPV finances the purchase price of the assets through the issuance of debt securities. The basic structure of a typical Dutch true sale transaction is set out in Figure 1.

Figure 1. Dutch True Sale Transaction



2.1 FUNDING OF DUTCH TRUE SALE TRANSACTION

2.1.1 TYPE OF SECURITIES

True sale securitisations are typically financed through the issue of debt securities. Depending on the type of underlying assets that are being securitised and the funding that is required, these securities can include securities with a short term (such as commercial paper) as well as securities with a medium to long term (such as medium-term notes and bonds). The securities can be publicly or privately issued.

In the case of a public issuance, the securities will typically be transferable and often be listed. Given the complexity of the transaction and the risks embedded in the securities, the securities are generally not offered to the public but to professional or otherwise sophisticated investors. This means that often the securities have a high denomination (e.g., EUR 100,000 or more) and that appropriate selling restrictions are imposed on any offering of these securities, so that they cannot be offered to retail investors.

The debt securities can in certain circumstances be used as collateral by financial investors for financing transactions with their central bank. In those circumstances, the securities (although listed) are typically not offered to the public but acquired by the originating financial institutions, which will then offer the securities as collateral to the central bank.

A typical Dutch RMBS provide financing for a fixed term and can therefore be characterised as a term securitisation. The term of the transaction can relate to the term or life of the asset that is being securitised or it can involve a shorter term, in which case arrangements will need to be made that ensure that at the time the transaction terminates, the SPV has funds available to repay the debt securities that it issued to fund the acquisition of the assets.

Because the debt securities issued in the context of a term securitisation typically have a medium to long-term maturity, they are suitable for listing and trading on securities markets. The debt securities issued by the SPV will be rated by credit rating agencies. Apart from the quality of the securitised assets, this credit rating is also dependent on the counterparties of the SPV, such as swap counterparties and liquidity providers. The credit rating agencies have specific criteria that apply to these counterparties. They also impose requirements on the terms of the swaps and liquidity arrangements into which the SPV may enter. The main purpose of these requirements is to ensure that the counterparty continues to meet the applicable credit rating criteria and that the SPV can use these arrangements when required. The documentation will therefore include fewer conditions precedent and events of default than can be found in ordinary lending or derivatives transactions.

If the term of the debt securities would be equal to the life of the securitised assets (e.g., mortgage loans with a term of thirty years or more), these securities may be less interesting for investors who may prefer securities with a shorter term. Therefore, many true sale term securitisations involving long-term assets contain features that allow the debt securities issued by the SPV to be redeemed prior to their legal maturity. There may even be an incentive to redeem the debt securities early by providing that after a certain period after issuance of the securities, for example five years, the interest rate on the securities will increase. This increase affects the cash flow in the transaction, and the amount that will be available to the originator after deduction of the funding costs incurred by the SPV will be reduced as a result. The originator will therefore have an interest in refinancing the transaction at that point in time, for example, by arranging a replacement transaction at cheaper interest rates.

If in a true sale transaction the securitised receivables are redeemed, this will in principle result in a corresponding redemption of the debt securities issued by the SPV. However, the terms of these transactions sometimes provide for a period during which the SPV can apply the redemption proceeds to acquire new receivables that meet the eligibility criteria. This mitigates the risk that the investors receive redemption payments prior to the expected maturity of the debt securities. The originator benefits from this arrangement because it can still use the full amount of the funding proceeds of the securitisation during this initial period.

The holders of the debt securities will normally be represented by a note trustee, which will be obliged to take certain actions (such as calling an event of default) if a minimum number of debt securities holders require the note trustee to do so. In this way one avoids the situation that a single debt securities holder can take action against the SPV. The note trustee can also act as representative of debt securities holders if certain minor changes are to be made to the terms of the transaction.[5] It is, therefore, not necessary to organise meetings of debt securities holders in order to effect these minor changes.

The SPV will have the benefit of liquidity or cash advance arrangements with an appropriately rated financial institution in order to ensure that the debt securities will not immediately default in cases of unforeseen liquidity shortages. This liquidity or cash advance arrangement is intended to cover temporary cash shortfalls and not to assume any default risk in relation to the securitised assets. The liquidity or cash advance arrangement is typically provided for a period of 364 days to ensure that it receives an advantageous regulatory capital treatment. The arrangement can, however, be renewed at the option of the SPV at the end of the 364-day period. The liquidity or cash advance provider is usually not obliged to agree to such renewal request albeit that in such circumstance the SPV will typically be entitled to fully draw the facility if no adequate replacement liquidity or cash advance facility arrangements are entered into.

The SPV will normally enter into derivatives transactions that hedge the mismatch between, on the one hand, the income received on the portfolio of securitised assets and, on the other hand, the interest it has to pay on the debt securities (so called securitisation swaps). This hedge arrangement can relate to specific cash flows (e.g., floating rate on the debt securities against an agreed fixed interest percentage) or to substantially all cash flows of the SPV (e.g., the SPV's funding costs against the income received by the SPV on the securitised assets). The swap counterparty of the SPV must be an appropriately rated financial institution in order to comply with the credit rating agency criteria that apply to the transaction. However, certain more recent Dutch RMBS are structured without the usual securitisation swap but they instead use interest rate caps purporting to mitigate the SPV's exposure to increasing floating rates above a certain cap strike rate, in return for payment of a premium by the SPV.

Depending on the portfolio characteristics of the assets forming part of the transaction and the envisaged capital structure of the transaction, reserve fund or similar structures are often used to provide for liquidity buffers for unforeseen liquidity shortages.

2.1.2 INFORMATION ABOUT DUTCH TRUE SALE TRANSACTIONS

Listed debt securities are subject to mandatory disclosure rules and disclosure requirements applicable to issuers thereof, in order to protect the interests of investors and to preserve an adequate functioning of the capital markets. Information about these transactions is generally available in the form of a prospectus that was prepared as part of the listing as well as investors' reports that disclose information about the performance of the transaction on a regular basis.[6] If the debt securities are rated, then the credit rating agencies will also have prepared reports.[7]

3. DUTCH SPECIAL PURPOSE VEHICLES

3.1 ORPHAN VERSUS ORIGINATOR SPV

Dutch true sale securitisations are generally structured around an entity that is specifically set up for such purpose, the SPV, whose role is effectively limited to acquiring a portfolio of assets and obtaining financing for such acquisition and entering into agreements in connection with, and useful to, such acquisition and financing (e.g., hedging and cash management and administration contracts). The aim of the transaction is usually to legally separate the assets to be securitised from the other assets and business undertakings of the originator, seller or sponsor that initiates the transaction.[8] By separating the assets from the originator, the originator's credit risk becomes less relevant.[9] This is necessary so that acceptable risk profiles for the debt securities issued by the SPV are obtained (i.e. so-called 'de-linkage' is achieved), and therefore ensure that such debt securities have lower interest rates.[10] Such risk profiles are linked to the quality and performance of the assets and the cash flows they produce.

In order to ensure that the SPV itself is not regarded an asset of the originator, the SPV is usually set up as an orphan company. In Dutch RMBS most orphan SPVs take the form of a Dutch private limited liability company (*besloten vennootschap met beperkte aansprakelijkheid*, BV or Dutch SPV).[11]

3.2 MANAGEMENT

In order to ensure that the SPV is managed independently from the originator and other participants in the transaction, usually an independent corporate service provider with the appropriate license under the Dutch Trust Companies Supervision Act (*Wet toezicht trustkantoren*), is introduced to act as sole director of the SPV. The terms of such management are incorporated in a management contract entered into between the corporate services provider and the SPV and – in addition to the terms relating to the scope of services to be provided and the remuneration of such services – aim to protect the interests of the SPV as a separate and independent legal entity. Such terms would typically include (without limitation) a covenant of the corporate services provider that: (i) the SPV (and its parent) will not undertake any business except the relevant transaction; (ii) the corporate services provider will manage the SPV in accordance with proper and prudent business practices; and (iii) the corporate services provider shall not resign as managing director except in pre-agreed circumstances.

Given that the business undertakings of corporate services providers are often limited to providing corporate housekeeping and management services, the SPV will have to appoint other third-party service providers to perform certain functions in respect of the transaction entered into by the SPV (e.g., servicing and administration of the assets acquired by the SPV and providing cash management and administration services). Such service providers are usually third parties but are often also originators or affiliates of such originators. If originators or their affiliates are appointed as service providers by the SPV, the agreements governing the terms of such agreements will have to include appropriate safeguards to avoid originators or employees of originators being held as a de facto director (*feitelijk bestuurder*) of the SPV or otherwise being held to have control over the SPV, which may have adverse tax and/or accounting consequences, and which may pierce the corporate veil.

Because of its limited purpose and function, the SPV will itself not have the infrastructure or experience to service and administer the acquired assets. Therefore, but also for commercial reasons, the originator (or seller) is usually appointed by the SPV to service and administer the assets. This means, for example, that in respect of loan receivables acquired by the SPV, the originator will continue to have direct contact with the debtors and will collect the payments from such debtors directly. For similar reasons the SPV will also enter into cash management and administration contracts providing for the appointment of third parties to perform certain cash management functions in connection with the cash flows received by the SPV and to be distributed to the investors and other creditors of the SPV.

3.3 BANKRUPTCY REMOTENESS

The transaction must be set up in a way that the SPV will be able to comply with its obligations under the various transaction documents, including the debt securities issued by it, and therefore to operate on a solvent basis. The predicted cash flow models in a transaction are essential: the expected cash flow generated by the assets (and the proceeds of a sale of such assets) must be sufficient to enable the SPV to service its debts. Therefore, as safeguard, the SPV is financed on a limited recourse basis, that is the payments under the debt securities issued by the SPV are either only due upon the SPV's receipt of payments under the securitised portfolio or the collateral, or only recoverable from and to the extent of the security interests created by the SPV over the securitised portfolio or collateral (and over any credit enhancement) in favour of the investors and other secured parties. Consequently, the investors (and other secured parties) are exposed to certain risks on the performance of the securitised portfolio and to the insolvency of the SPV. The extent of this risk will depend on the security granted to the investors, and the strength of the credit enhancement (such as guarantees or insurances) provided by third parties.

Because of the adverse consequences connected with the SPV's bankruptcy and to preserve the status and priority of the creditors of the SPV participating in the transaction (including the investors), the SPV is made 'bankruptcy remote' (i.e., isolated from compulsory or voluntary insolvency proceedings). Bankruptcy remoteness would normally involve a combination of any of the following measures:

(a) the arranger(s) of the transaction would select a corporate services provider to incorporate the foundation, which in turn incorporates the SPV (see also paragraph 3.1 above). The corporate services provider can also serve as managing director of the SPV and gives certain covenants in the management agreement in relation to the restrictive business undertakings of the SPV (see also paragraph 3.2 above);

(b) the SPV's articles of association should have a very limited objects clause dealing specifically with the relevant transaction (see also paragraph 3.1 above). This restriction should be repeated in the principal contracts to which the SPV is a party;

(c) all parties contracting with the SPV would covenant that they will not take any action to have the SPV liquidated, dissolved, or declared bankrupt until such time as all amounts payable in respect of the debt securities have been paid; and

(d) the only creditors that the SPV should have which would not be bound by a non-petition for bankruptcy provision would be the chamber of commerce in whose commercial register the SPV is registered (for annual registration fees), external advisers of the SPV and the tax authorities. As regards these creditors, it is common practice to ensure that the taxes and fees payable by the SPV to them on an ongoing basis can be met from the SPV's earnings and are listed high in the so-called waterfall of payment priorities. Furthermore, the SPV should not have employees.

As to paragraph (c), under Dutch law parties can contractually prohibit or limit a party's right to petition for the bankruptcy (*faillissement*) of its counterparty. However, it is possible that a Dutch court would deal with a petition for bankruptcy, notwithstanding that such petition has been presented in breach of such non-petition covenant. The court in dealing with the petition may arrive at the conclusion that the SPV has ceased to pay its debts as they fall due (being the legal ground for bankruptcy in the Netherlands[12]). A Dutch court may also deal with a petition for suspension of payments (*surseance van betaling*), which can only be requested by the debtor (i.e., SPV) itself.[13]

4. SELECTED REGULATORY REQUIREMENTS

4.1 DUTCH BANKING REGULATIONS

In respect of Dutch SPVs, under the current Dutch banking regulations as laid down in the Dutch Financial Supervision Act (*Wet op het financieel toezicht*, FSA) and various implementing decrees:

(a) an SPV is not subject to these regulations if it issues debt securities with a denomination of at least EUR 100,000 or equivalence in other currency;[14] [15]

(b) there is no minimum maturity requirement applicable to the funding of the SPV;

(c) in relation to monies that an SPV borrows under normal loan facilities (e.g., liquidity or cash advance facilities), the SPV may solicit and borrow such monies if the aggregate facility amount and the minimum drawdown amount are at least EUR 100,000;[16] and

(d) the SPV will be permitted to grant and to purchase (interests in) loans made to, and other receivables relating to indebtedness of, Dutch and foreign corporate borrowers (for consumer borrowers, see paragraph 4.3 below), and the SPV will also be permitted to invest in other assets.

4.2 ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE

The SPV could in certain transaction structures be considered an alternative investment fund (AIF) within the meaning of Directive 2011/61/EU (AIFMD), also taking into account ESMA's final report on the guidelines on key concepts of the AIFMD. This directive defines an AIF as a collective investment undertaking (other than a UCITS, as defined in Directive 2009/65/EC) which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. An SPV in a typical Dutch securitisation will not qualify as a UCITS given the basis on which it holds the assets and the manner in which it is funded. Furthermore, an SPV used in a public Dutch RMBS should be able to benefit from a limitation of the scope of the AIFMD pursuant to article 2(3)(g) of the AIFMD which exempts "securitisation special purpose vehicles" from the AIFM's scope. A securitisation special purpose vehicle is defined in article 4(1)(an) of the AIFMD as an entity whose sole purpose is to carry on a securitisation or securitisations as defined in Regulation 2009/24/EC (replaced by Regulation 1075/2013/EU of the European Central Bank).

4.3 PROSPECTUS REQUIREMENTS

The Prospectus Directive (Directive 2003/71/EC as amended, including by Directive 2010/73/EU), has been implemented in the FSA, which imposes prospectus and continuous disclosure requirements on an SPV issuing debt securities. These requirements do not apply if the debt securities issued by the SPV have a denomination of at least EUR 100,000 or equivalence in other currency unless such debt securities are (to be) listed on a regulated market (e.g., Euronext Amsterdam, a regulated market of Euronext Amsterdam N.V.), in which case a prospectus will have to be made available by the SPV satisfying the disclosure requirements of the Prospectus Directive as implemented in the FSA.

4.4 CONSUMER CREDIT REGULATIONS

By acquiring consumer receivables, the SPV in Dutch RMBS is deemed to provide consumer credit, which is a licensable activity under the FSA.[17] The SPV can rely on an exemption from this license requirement if the SPV outsources the servicing of the consumer receivables and the administration thereof to an entity which is adequately licensed under the FSA to act as consumer credit provider or intermediary and which complies with certain information duties towards debtors of consumer receivables.[18] Usually a servicing contract is entered into by the SPV with the originator (or any other party to which the originator had already outsourced the servicing and administration of the consumer receivables) pursuant to which the SPV outsources the servicing and administration of the consumer receivables to such party. In the servicing contract the servicer, amongst other things, would represent and warrant that it is, and covenant that it shall remain, licensed under the FSA to act as consumer credit provider or intermediary, and furthermore covenant that it shall comply with the information duties towards the debtors under the FSA. In addition, such servicing contract would contain provisions in respect of termination of the appointment of the servicer and the requirement for the SPV to appoint a substitute servicer prior to such termination becoming effective.

4.5 DATA PROTECTION AND CONFIDENTIALITY REGULATIONS

In respect of true sale transactions (in particular transactions involving consumer receivables) data protection rules, including those laid down in the Dutch Data Protection Act (*Wet bescherming persoonsgegevens*), and confidentiality arrangements, may be relevant and may restrict the provision of (personal) data of debtors in the securitised portfolio by the originator to the various parties involved in the transaction (e.g., SPV, security trustee, verification agents and credit rating agencies), and/or may require the prior consent of such debtors for the provision of such data and/or a notification to the competent public authorities. To ensure compliance with data protection rules, transactions often include escrow arrangements pursuant to which personal data of debtors in the securitised portfolio will be provided by the originator or servicer to an escrow agent in encrypted form, which data may only be released by the escrow agent to the SPV and security trustee in default scenarios under the transaction, or otherwise in connection with the enforcement of the securitised portfolio.

4.6 CERTAIN MANDATORY REPORTING REQUIREMENTS[19]

On 1 January 2009 new rules further implementing the EU Transparency Directive (2004/109/EC, as amended by Directive 2013/50/EC) came into force in the Netherlands. They are incorporated in the FSA and various implementing decrees. Pursuant to the FSA the (periodic) financial reporting requirements do not apply to an issuer exclusively of debt securities with a denomination of at least EUR 100,000 or equivalence in other currency. However, the requirements of the Dutch Civil Code (*Burgerlijk Wetboek*, DCC), in particular those regarding the publication and filing of the annual financial accounts and annual reports will nevertheless apply to any company with its official corporate seat in the Netherlands. Also, pursuant to the requirements of the DCC, a Dutch SPV must have its accounts audited if its securities are listed on a regulated market. In addition, if the securities issued by the Dutch SPV are listed on a regulated market, the relevant rules also contain incidental reporting obligations (e.g., changes in the rights attaching to securities and price sensitive information), provisions on the equal treatment of securities holders, and certain specific information requirements (e.g., maintaining a website).

Furthermore, for transparency, capital adequacy, ECB eligibility, mandatory due diligence and other purposes (as the case may be), various EU and domestic legislation (including, without limitation, CRR, AIFMR, CRAIII and the ECB Regulation), requires issuers of securitisation exposures, originators and/or other relevant parties to disclose information on the securitisation and the securitised assets (e.g., loan level data) at inception and during the life of the transaction.[20]

4.7 EUROPEAN MARKET INFRASTRUCTURE REGULATION (EMIR)

Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (EMIR) and its various technical standards impose a range of obligations on parties to OTC derivative contracts (according to whether they are "financial counterparties" such as investment firms, credit institutions and insurance companies, or other entities which are "non-financial counterparties") to improve transparency and reduce the risks associated with the derivatives market. Financial counterparties are subject to a general obligation to clear through a duly authorised or recognised central counterparty (the "clearing obligation") all "eligible" OTC derivative contracts entered into with other counterparties that are subject to the clearing obligation. They must also report the details of all derivative contracts (i.e. not only OTC derivatives) to a trade repository (the "reporting obligation"), and undertake certain risk-mitigation techniques in respect of OTC derivative contracts which are not cleared by a central counterparty such as timely confirmation of terms, portfolio reconciliation and compression and the implementation of dispute resolution procedures (the "risk mitigation obligations").

The reporting obligation and risk mitigation obligations also apply to non-financial counterparties. However, non-financial counterparties are exempt from the clearing obligation and certain additional risk mitigation obligations (such as the posting of margin for uncleared OTC derivatives) provided the gross notional value of all derivative contracts entered into by the non-financial counterparty and other non-financial counterparties within its "group" (as defined in EMIR), excluding eligible hedging transactions, do not exceed certain thresholds (set per asset class of OTC derivatives).

An SPV used in a Dutch RMBS usually qualifies as a non-financial counterparty. However, if such SPV would be considered to be a member of a "group" and if the gross notional value of non-hedging OTC derivative contracts entered into by such SPV and the other non-financial counterparties that are members of the group exceeds the applicable threshold, such SPV would be subject to the clearing obligation. Whilst the swap(s) entered into by an SPV in the context of a Dutch RMBS is usually expected to be treated as a hedging transaction and deducted from the total in assessing whether the gross notional value of derivative contracts entered by such SPV or its "group", the competent regulator may take a different view or the SPV's status may change.

If the SPV or its "group" were to exceed the applicable clearing thresholds, the SPV would be required to clear any eligible OTC derivatives contracts, which could also entail the posting of margin. It would also be subject to the full set of risk mitigation obligations, which means that even if a securitisation swap, taking into account its characteristics, would not qualify as an eligible OTC derivative contract for clearing purposes, mandatory margining requirements may nonetheless apply to the SPV in relation to such swap.[21] If an SPV in a securitisation would for the above reasons become subject to clearing or margin posting requirements, the transaction or cashflow structure of a securitisation may need to modified in order to ensure that the SPV is able to comply with such requirements.

4.8 LICENSING ISSUES

Any party which provides securities, banking or insurance services to a Dutch SPV should be authorised to conduct business in the Netherlands, either by having a license or – for EU entities – by having the relevant services passported under the applicable EU directives. This would typically apply to all hedging counterparties and liquidity or cash advance facility providers.

5. LEGAL STRUCTURE

5.1 TRANSFER TECHNIQUES

The appropriate method of transferring receivables under Dutch law is by way of assignment (*cessie*).[22] A transfer of receivables can either take the form of a disclosed assignment (*openbare cessie*)[23] or, provided that the receivables exist or arise from a legal relationship existing at the time of such transfer, undisclosed assignment (*stille cessie*).[24] A disclosed assignment, in order to be effective, must be notified to the debtor of the receivable. For an undisclosed assignment to be effective, the deed of assignment should either be included in a notarial deed or registered with the Dutch tax authorities. In the case of an undisclosed assignment, notification to the debtor will still be required to avoid such debtor validly discharging its obligations (*bevrijdend betalen*) by making a payment to the assignor of the receivable.

Often, the originator of the receivables will be the seller and transferor of the receivable. However, it is possible that the originator has already prior to the transaction transferred the receivable to another party. It may then be necessary to conduct due diligence on the previous transfer(s) and the transaction terms may need to be adapted to reflect this situation. We have for the purpose of this note assumed that the originator also acts as seller and transferor of the receivables.

In particular in transactions involving consumer receivables, the transfer of receivables is usually for commercial reasons effected by way of silent assignment and will therefore not be notified to the debtors of receivables, except if certain events (e.g., payment defaults, insolvency events and credit ratings downgrades) in respect of the originator occur. As long as no notification of the assignment of the receivables from the originator to the SPV has taken place, payments made by the debtors under the receivables must continue to be made to the originator.

To protect the interests of the SPV (and the security trustee), the purchase contract would usually contain, in addition to representations and warranties in relation to the receivables, covenants from the originator pursuant to which the originator on-pays to the SPV any proceeds received (or deemed received, for example as a result of set-off) in respect of the receivables until notification of the assignment of the receivables has been given to the debtors. Furthermore, the originator would agree not to transfer or encumber the receivables to, or in favour of, any third party (other than the SPV).

It has been debated in respect of Dutch securitisation transactions whether such transactions are at risk to be re-characterised as a secured loan (rather than a sale) as a result of which a transfer of receivables in respect thereof would be void as a matter of Dutch law.[25] As long as the parties indeed intend to accomplish a sale by the originator of the receivables to the SPV and, in connection with such sale, a transfer of the receivables from the originator to the SPV resulting in the SPV receiving full title to the receivables (which one would typically intend if the SPV is required to pledge the acquired receivables in favour of the security trustee as security for the SPV's obligations and the SPV is free to dispose of the receivables once acquired) rather than merely some form of security interest, there is, in principle, no reason for concern that such transfer would be void as a matter of Dutch law.[26]

5.1.1 TRANSFER RESTRICTIONS

In determining the legal feasibility of a true sale transaction it is particularly relevant to determine whether the contract pursuant to which the receivable is originated does not restrict or prohibit an assignment or transfer of such receivables. Under Dutch law, a party to a contract may assign its rights under such contract unless such transfer is prohibited or restricted by law or contract, or such right is a personal right (which by its nature is non-transferable).[27] A contractual restriction or prohibition on assignment is valid under Dutch law and can, depending on its wording, have property law consequences (*goederenrechtelijke werking*), that is, actually prevent the receivable from being transferred. Recent case law has confirmed that it is a matter of interpretation of the relevant clause to establish whether parties had the aim to give such clause 'proprietary effect' (*goederenrechtelijk effect*). It should however be clear from the wording that parties had such aim. Any assignment by an originator contrary to such provision with proprietary effect would be invalid and would not bind the debtor of the receivable purported to be assigned. A breach of a contractual restriction or prohibition on assignment could constitute a breach of contract by the originator and expose it (or even the SPV in exceptional circumstances) to liability for damages (if any) incurred by the debtor.

As part of the due diligence process, the contract or, in respect of large portfolios, a representative sample or standard form contract, would usually be reviewed to determine whether an assignment of rights under such contract is allowed without involvement of the debtor of the receivable and/or does not result in a contractual breach towards the debtor.[28] If a securitisation transaction would nevertheless be intended in respect of (a portfolio of) receivables the transfer of which is contractually restricted or prohibited, depending on the purpose of such transaction, a synthetic structure may be a suitable alternative.

5.1.2 SECURITY

In a true sale transaction it is relevant to determine whether upon an assignment of a receivable by the originator to the SPV, the SPV shall also have the benefit of any security rights granted to secure such receivable (e.g., a mortgage securing a loan). According to section 3:7 DCC accessory rights (*afhankelijke rechten*) are rights which are connected to another right in such a manner that they cannot exist without the other right, such as security rights. Accessory rights connected to a receivable are also ancillary rights (*nevenrechten*). Section 6:142 DCC describes ancillary rights by giving examples: security rights, privileges, the right of enforcement and the right to stipulated interest or a penalty. This list is not exhaustive. Accessory rights follow the right with which they are connected. Consequently, if a receivable is transferred, in principle the accessory rights and the ancillary rights pass by operation of law to the transferee of the receivable, except if the right by its nature is, or has been construed by the parties as, a purely personal right of the transferor. This means that upon an assignment of a receivable by the originator to the SPV, the SPV shall also have the benefit of a security right granted to secure such receivable unless such security right is a personal right of the originator.

Dutch banks generally use bank (or all-monies) mortgages (*bankhypotheken*) and/or credit mortgages (*krediethypotheken*) in their secured financing arrangements with their borrowers.[29] Contrary to fixed mortgages (*vaste hypotheken*), which only secure a certain loan or other type of credit, bank mortgages not only secure a loan but also any other amounts that are or may become due from such borrower to the bank as a result of loans, current account claims or claims of whatever nature. Credit mortgages are similar to bank mortgages but are usually restricted to current account or similar types of credit claims.

It is not clear in all circumstances whether, in the case of an assignment or pledge of a receivable secured by a bank mortgage, the mortgage rights created by the bank mortgage will follow such receivable. Case law indicates that the question of whether the mortgage rights created by the bank mortgage will follow the receivables is dependent on the intention of the parties at the time that they entered into the mortgage deed.[30] In determining whether a bank mortgage follows the receivable to which it is connected, the wording of the mortgage deed is a clear indication of the intentions of the parties. If the mortgage deed does not contain any explicit provision as to whether the mortgage right partially follows the receivable upon assignment or pledge of such receivable to a third party (e.g., an SPV or a security trustee), the mortgage right, taking into account the nature of a mortgage right as an ancillary right rather than a personal and an independent right, will partially follow the receivable upon assignment or pledge of such receivable to a third party, unless the parties to the mortgage deed actually intended the mortgage right to be a personal and independent right of the mortgagee rather than a right that is ancillary to the receivables it purports to secure.

As a consequence of a transfer by the originator of a receivable secured by a bank mortgage (or fixed mortgage if not all receivables which are secured by such mortgage are transferred) to the SPV, the mortgage right would be co-held by the SPV and the originator.[31] This implies that in the case of foreclosure of the mortgage, the originator and the SPV in principle need to act jointly and share the proceeds pro rata on the basis of their respective shares in the joint estate (*gemeenschap*). Therefore, the purchase contract in a Dutch RMBS would typically contain arrangements between the originator, the SPV and security trustee (in connection with the right of pledge created by the SPV over the receivables to the security trustee) as to the management, administration and enforcement of such joint security rights. However, such arrangements may not be enforceable in all respects to the extent that they are inconsistent with the Dutch mandatory rules applying to co-held interests.[32]

Furthermore, under Dutch law no statutory provision exists on the issue of whether upon the creation of a right of pledge on a receivable and notification thereof to the debtor, the pledgee is entitled to exercise the accessory rights and the ancillary rights connected to the receivable upon the exercise of the pledged rights. In Dutch legal literature to date the most commonly held view is that security rights, such as mortgage rights, can be exercised by the pledgee, either because a right of pledge should be regarded as a partial transfer of the receivable (and that the accessory and ancillary rights follow in as far as they are connected to the powers transferred to the pledgee), or because the person who is entitled to collect the receivable (*inningsbevoegde*) (e.g., in respect of a disclosed right of pledge, the pledgee) is also deemed to be entitled to enforce the related security. This view is also supported by a decision of the

Dutch Supreme Court (*Hoge Raad der Nederlanden*) on the attachment (*beslag*) of a claim secured by a right of mortgage.[33]

5.2 SELECTED LEGAL ISSUES

5.2.1 IMPACT OF INSOLVENCY ON ASSIGNMENT

Registration of a deed of assignment (in the case of an undisclosed assignment) and notification of a deed of assignment to a debtor (in the case of a disclosed assignment) after the transferor (e.g., an originator) has been declared bankrupt (*failliet verklaard*) or has become subject to a suspension of payments (*surseance van betaling*) or, as the case may be, emergency regulations (*noodregeling*) within the meaning of the FSA, in the Netherlands (together insolvency proceedings), will not be effective and, consequently, in such event the receivables will not have been validly transferred from the transferor to the transferee (i.e., the SPV).[34] Assuming that an assignment has been perfected either by registration of the deed of assignment with the Dutch tax authorities (in the case of an undisclosed assignment) or by notification of the assignment to the debtor of the receivable (in the case of a disclosed assignment) prior to insolvency proceedings becoming effective in respect of the transferor, the validity of such assignment will not be affected as a result of such transferor being subsequently subjected to insolvency proceedings. Notification of a perfected undisclosed assignment of receivables can still be validly given to the debtors of such receivables after the transferor has been subjected to insolvency proceedings.

However, (the validity of) such transaction could still be challenged for other reasons, for example, because the transaction is held not to be in the originator's corporate interests[35] or held to be prejudicial to the interests of other creditors of the originator, and the originator and SPV are or should have been aware of this at the time that they entered into such transaction.[36]

As long as no notification of the assignment has taken place, any payments made by the debtor under a receivable must continue to be made to the originator. In respect of payments so made prior to insolvency proceedings of the originator, the SPV will be an ordinary, non-preferred creditor, having an insolvency claim (*voor verificatie vatbare vordering*). In respect of post-insolvency payments, the SPV will be a creditor of the estate (*boedelschuldeiser*), and will receive payment prior to creditors with insolvency claims, but after preferred creditors of the estate. Creditors of insolvency claims have to share in the general insolvency costs and have to await finalisation of a (provisional) distribution list ((*voorlopige) uitdelingslijst*).

5.2.2 SET-OFF AND DEDUCTION

Set-off risk plays an important role in structuring a securitisation, in particular if banks as originators are involved, since an SPV after having purchased a receivable from the originator may not receive all proceeds to which it is entitled in respect of such receivable if the debtor of such receivable invokes a set-off right (*verrekeningsrecht*) or similar deduction right against such originator. For example, this can be relevant in respect of deposits or savings held by a debtor with an originator or damages claims of a debtor against the originator as a result of acts performed by such originator (e.g., in relation to providing inappropriate investment advice, etc.).

The set-off risk is equally relevant in relation to mortgage loans which are linked to bank savings products. Under the terms of these products, the borrower is required to deposit on a regular basis amounts in a blocked bank savings account, the proceeds of which are used at maturity of the mortgage loans to repay the mortgage loan (bank savings mortgage loans). Amounts standing to the credit of such bank savings accounts will if the deposit guarantee scheme is activated in respect of the account bank by the Dutch Central Bank or the account bank is subjected to emergency regulations (*noodregeling*) or declared bankrupt (*failliet*), by operation of law be set-off against the related bank savings mortgage loans, irrespective of whether such mortgage loans are owed to the account bank or a third party, such as the originator or the SPV.

In a true sale transaction, the purchase contract for the receivables would typically provide that an originator shall pay amounts equal to the difference between the amounts which are set-off and which should have been received by the SPV and the amounts that have actually been received by the SPV in respect of the receivable. This is, however, a contractual obligation only and the SPV incurs credit risk on the originator. Transactions involving large loan portfolios therefore usually contain concentration limits in respect of categories of debtors in respect of which set-off risk is believed to be material (e.g., residential mortgage loans granted to employees of the originator) or (other) credit risk mitigation solutions such as set-off deposit reserves which must be created upon a credit ratings downgrade of the originator, or the inclusion of sub-participation arrangements relating to bank savings mortgage loans. Pursuant to such sub-participation arrangement the account bank or originator participates in the receivables acquired by the SPV, for a purchase price equal to the savings received in the bank savings account.

Unless contractual set-off rights are validly waived by the debtor in the loan contract,[37] under Dutch law a debtor will be entitled to set-off amounts due by the originator with amounts the debtor owes to the originator in respect of the receivable, provided that the legal requirements (such as mutuality) for set-off are met.[38] After an assignment or pledge of the receivable to the SPV or security trustee, as the case may be, and notification to the debtor, the debtor will also be entitled to such set-off rights – again provided that the legal requirements for set-off are met – and furthermore provided that:

(a) the counterclaim of the debtor results from the same legal relationship (*rechtsverhouding*) as the transferred (or pledged) receivable; or

(b) the counterclaim of the debtor came into existence and became due and payable prior to the transfer (or pledge) of the receivable and notification thereof to the debtor.[39]

Similar deduction risks often play a role in Dutch RMBS in respect of mortgage loans that are combined with insurance products. It is intended that the mortgage loan is repaid at its maturity with the income generated by the insurance product during the life of the mortgage loan which is paid out at maturity of the mortgage loan. If in these circumstances the insurance company – for example, as a result of its insolvency – would not pay out the insurance proceeds, the debtor may try to invoke set-off rights or similar defences. The mutuality requirement for set-off as described under (a) above may not be met if the insurance company is a separate legal entity, a debtor could also argue, based on the applicable mortgage and insurance conditions and other documents (or oral statements) relating to the marketing and origination of the mortgage loan, and the intention of the parties involved, that the mortgage loan and insurance policy are to be regarded as one inter-related legal relationship and that as a result thereof the debtor does not have to repay (part of) the mortgage loan if the debtor has failed to receive the insurance proceeds.

This deduction risk is often mitigated in respect of certain types of mortgage loans through a sub-participation arrangement pursuant to which the insurance company or originator participates in the receivables acquired by the SPV, for a purchase price equal to the premium received under the related insurance policies.

5.2.3 INTEREST RATE RESET

In Dutch RMBS involving Dutch law governed loan receivables bearing a fixed or floating interest rate for a fixed period, it is uncertain whether the right to reset the interest rate upon termination of the agreed fixed interest period is transferred to the SPV upon a transfer of the loan receivable. The reason for uncertainty is that neither statute nor case law explicitly deals with this question. It is often argued that such interest reset rate is an ancillary right which by nature follows the right to which it is connected (i.e., the loan receivable) unless it is a personal right of the initial creditor (i.e., the originator). This argument is based on the fact that section 6:142 DCC explicitly refers to the right to stipulated interest as an example of an ancillary right. If the right to reset the interest rate should be considered as a right to further determine the content of the right to stipulated interest it would qualify as an ancillary right. If the loan receivable itself cannot be considered a personal right of the initial creditor (e.g., because the loan contract is silent on this matter) it seems difficult to argue that the right to stipulated interest and the interest rate reset right in respect of such loan receivable should nonetheless be considered personal rights.

If the interest reset right constitutes an independent right, which is not connected to the loan receivable, it would have to be considered to what extent such right is itself transferable. Since one would expect an interest rate reset right to be exercisable at the discretion of the creditor) it should in that case be regarded as a discretionary right (*wilsrecht*), which if considered a proprietary right (*vermogensrecht*), is in principle transferable.[40]

If an interest rate reset right cannot be regarded a discretionary right or proprietary right it should upon a transfer of the related loan receivable either remain with the initial creditor or terminate by operation of law. If it were to remain with the initial creditor, the initial creditor would, in principle, have to comply with the interest reset instructions given by the transferee of the loan receivable, since the initial creditor would itself no longer be legally entitled to the loan receivable. Any discretion exercised by such initial creditor without taking into account the instructions of the transferee could result in abuse of power (*misbruik van bevoegdheid*) and expose the initial creditor to liability against the transferee, either on the basis of tort or breach of contract.

If the interest rate reset right were to terminate by operation of law, this would change the identity and characteristics of the related (interest bearing) loan receivable, which would be contrary to the principle that upon a transfer of a receivable the identity and content of such receivable remains unchanged.[41]

6. CREDIT ENHANCEMENT

6.1 GENERAL

The creditworthiness of an SPV or the quality of the debt securities issued by the SPV can be enhanced by using various financing techniques that reduce the likelihood of default by the SPV or on the debt securities issued by the SPV.

The credit rating agencies have established models and credit rating requirements to determine the credit rating of the debt securities issued by the SPV. These models and requirements will take account of the credit enhancement included in a transaction. As a result, the credit rating of the debt securities issued by the SPV can be increased if on the basis of these models and requirements, the credit rating agencies conclude that the creditworthiness of the SPV or the debt securities issued by the SPV has been sufficiently increased. A higher credit rating (and the lower risk profile) should correspond to lower interest rates. However, credit enhancement also comes at a cost. An originator will need to consider whether, when the costs of credit enhancement are taken into account, the lower interest rates will indeed result in overall cheaper funding costs.

The techniques that are most frequently used in a Dutch RMBS are described below. A transaction will typically include a combination of these techniques.

6.2 SUBORDINATION

Credit enhancement can be provided to one or more tranches of debt of the SPV by subordinating other debt obligations of the SPV to the obligations of this tranche or tranches. This implies that in the event of losses on the portfolio of assets, rather than having such losses allocated to all outstanding debt of the SPV on a pro rata basis, such losses are first absorbed by the lower ranking debt obligations. As a result, the chances of repayments in full of the senior tranches of debt are higher than on the lower tranches, and the credit ratings attributed to the debt will reflect this risk allocation. Because of this risk allocation, interest rates on the lower ranking tranches will be higher than the interest rates on the more senior tranches.

Given the higher interest rate that is generally paid on the junior debt, it may be attractive to certain sophisticated investors that are willing to assume the risk.

The terms of the subordination in transaction will provide that the holders of junior debt are not entitled to payments of interest and principal until interest and principal on the senior debt obligations have been paid. In addition, they will also provide that the junior debt holders cannot take any enforcement or other action under their debt arrangements unless the holders of the senior debt agree. Amendments to any of the terms of the junior debt arrangements will require the approval of the senior debt holders.

Under Dutch law, the legal basis for subordination can be found in section 3:277(2) DCC.[42] The provision states that a creditor can agree with the debtor that the creditor's claim against the debtor will be given a lower ranking in relation to all or specific creditors than the law provides. The agreement must be made between the debtor and the creditor and not between the creditors concerned only. The SPV must therefore be a party to the subordination arrangements, and the creditors should ensure that the subordination agreement cannot be amended without the consent of all affected creditors by for example stipulating that the debtor is not allowed to enter into different arrangements with one or more creditors unless all other creditors approve.

In this respect, it is noted that there are EU risk retention and due diligence requirements which currently apply, or are expected to apply in the future, in respect of various types of EU regulated investors including credit institutions, authorised alternative investment fund managers, investment firms, insurance and reinsurance undertakings and UCITS funds.[43] Amongst other things, such requirements restrict an investor from investing in asset-backed securities unless (i) that investor is able to demonstrate that it has undertaken certain due diligence in respect of various matters including its note position, the underlying assets and (ii) (in the case of certain types of investors) the originator, sponsor or original lender in respect of the securitisation has explicitly disclosed to the investor that it will retain, on an on-going basis, a material net economic interest of not less than 5 per cent. in total in respect of certain specified credit risk tranches or asset exposures. To date, most Dutch RMBS purport to comply with the applicable retention requirements by providing that the originator shall hold the first loss tranches of debt instruments issued by the SPV and, if necessary, other tranches having the same or a more severe risk profile than those sold to investors.

6.3 OVERCOLLATERISATION

In most true sale transactions, overcollateralisation is being used. It implies that the value of the assets which the originator transfers to the SPV is greater than the consideration paid by the latter to the originator. The funding that the SPV requires for paying the consideration will be less than the value of the assets, so that there is a buffer against defaults under the cash flows received from these assets.

A transfer of assets for a consideration less than their value is potentially prejudicial to creditors of the originator and could result in tax and accounting issues (because the originator could be deemed to have made a loss on the sale of the assets to the SPV). Therefore the terms of the sale will provide that the consideration paid by the SPV at the time that the assets are transferred to the SPV constitutes initial consideration and that the originator is entitled to deferred consideration as and when the SPV has funds available for this purpose on the basis of the applicable priority of payments. This deferred consideration will be calculated by reference to the portfolio as a whole and will not be allocated to particular assets. On the basis that, if the originator had kept the assets, it will also have suffered the defaults and would have to pay for funding costs, it can be argued that in these circumstances, there should be no reason for creditors of the originators to challenge a transfer of assets on this basis.

A transaction can also involve more than one originator, in which case it would be possible to introduce a form of cross-collateralisation. This means that for the determination of the available deferred consideration, the cash flows of the total asset portfolio (including the assets of all originators) rather than the assets of a particular originator are considered. Each originator will be entitled to, generally, a pro rata part of the available surplus cash flows by way of deferred consideration.

If the credit quality of the portfolios of the various originators differs, the originator with the portfolio of better quality is providing support to the originator with the portfolio of weaker quality. This could give rise to corporate law (corporate benefit) and voidable preference (*pauliana*) issues. These issues must be considered from the perspective of each originator that is involved in the transaction.

6.4 RESERVES

The SPV typically receives in a true sale transaction more income than the amounts of its funding costs and expenses. The surplus will normally be paid out to the originator by way of deferred consideration (see paragraph 6.3 above). The terms of the transaction will normally provide that a part of this surplus is retained by the SPV and this will be added to, or used as, a reserve. The amount of the reserve is generally calculated as a percentage of the amounts due under the assets or the SPV's debt obligations with a minimum (absolute) amount. If the reserve has reached the agreed amounts, surplus proceeds will no longer need to be retained. If the agreed reserve amount is reduced (e.g., because the amounts due under the assets are reduced through payments), amounts can be released from the reserve and paid to the originator as deferred consideration.

An SPV can maintain several types of reserves, for example, a default reserve that can be applied to cover unexpected or expected costs and expenses of the SPV as well as any losses that the SPV may suffer as a result of a payment or other default.

If the SPV has agreed to swap its cash flows resulting from the securitised assets against the amount due by it as funding costs, the arrangements can provide that the SPV must retain a certain part of its cash flows, generally based on a percentage of the amounts due on the assets or the debt obligations it has outstanding. This amount will be applied to establish and fund a reserve.

In some circumstances (local true sale requirements or tax or accountancy treatment) it may be preferable that the assets are transferred by the originator to the SPV against their fair market value and that the originator (or an affiliated company) grants a subordinated loan to the SPV. The proceeds of this subordinated loan can be used to fund a reserve that can be used to compensate for any losses incurred on the asset portfolio. The subordinated loan will be repaid at the end of the transaction to the extent that there are remaining funds to the reserve (or earlier, if the reserve has been funded through cash flow generated by the assets).

6.5 EXTERNAL SUPPORT TO SPV

There are various other ways in which an SPV can be supported in order to increase its creditworthiness. For example, the swap agreement pursuant to which income on the assets is swapped against the SPV's funding costs can provide that the swap counterparty remains obliged to pay the SPV's funding costs, even if the income in respect of the assets is reduced as a result of defaults. In these circumstances the swap counterparty will, in fact, be providing credit support to the transaction. This may also have an impact on the capital adequacy and accounting treatment of the swap.

7. TRANSACTION SECURITY

7.1 LEGAL STRUCTURE

It is usually intended to create an efficient security structure whereby a representative of the creditors of the SPV (security trustee) is appointed to hold the security for the ultimate benefit of such creditors to avoid that – at least in respect of Dutch RMBS – a co-shared security right (*gemeenschappelijk zekerheidsrecht*)[44] may arise which by operation would be the case if such security was held by two or more creditors jointly. Co-shared security rights are avoided since the cooperation of the co-holders of such security could be required should a holder wish to enforce such security (which could result in undesirable enforcement disputes and/or delays), and such security would have to be re-created if new additional creditors were to be introduced into the transaction (e.g., in the case of a tap or further issue of notes under a securitisation programme).

However, it is uncertain under Dutch law whether a security right can be validly created in favour of a party that is not the creditor of the claim which the security right purports to secure.[45] To address this uncertainty in Dutch RMBS, the SPV – as a separate and independent obligation –would undertake to pay to the security trustee amounts equal to the amounts due by the SPV to the secured parties. Such arrangement is commonly referred to as a parallel debt arrangement.[46] Such parallel debt in principle creates a claim of the security trustee against the Dutch SPV which can be secured by a Dutch right of pledge.[47] In addition, it would have to be provided that upon enforcement of such right of pledge, the security trustee shall distribute the enforcement proceeds to the creditors of the Dutch SPV in accordance with the pre-agreed waterfall of payment priorities.

7.2 SECURITY TYPES

Even though the SPV is made bankruptcy remote it is common practice for true sale securitisation transactions to include security arrangements to further strengthen the position of the investors and certain other creditors of the SPV in the event that the SPV would default on its payment obligations. In most securitisations all material assets of the SPV serve as collateral for the SPV's payment obligations. A typical security package in a Dutch true sale securitisation would include:

(a) An undisclosed first ranking right of pledge (*pandrecht*)[48] over (Dutch law governed) receivables (and related rights) acquired by the SPV;

(b) a disclosed first ranking right of pledge over the bank accounts (and related rights) of the SPV located in the Netherlands; and

(c) a disclosed first ranking right of pledge over the rights of the SPV under the (most important) transaction documents (e.g., purchase, servicing, cash management and hedging contracts).

Under Dutch law a right of pledge over receivables and other contractual rights can take the form of a disclosed right of pledge (*openbaar pandrecht*) or undisclosed right of pledge (*stil pandrecht*). In order for a disclosed right of pledge to be effective, the deed of pledge must be notified to the debtor of the receivable. For an undisclosed right of pledge to be effective, the deed of pledge should either be included in a notarial deed or registered with the competent Dutch tax authorities. In the case of an undisclosed right of pledge, notification to the debtor will still be required to ensure that such debtor can no longer validly discharge its obligations (*bevrijdend betalen*) by making a payment to the pledgor of the receivable (e.g., the SPV).

7.3 SECURITY TRUSTEE

In Dutch RMBS a security trustee has effectively two roles, namely: (i) it is appointed by the investors as their representative (note trustee) to hold the benefit of rights and covenants granted by the SPV in respect of the debt securities; and (ii) it holds the security granted by the SPV for the ultimate benefit of the investors and other parties in the transaction whose interests are secured (see paragraph 7.1 above). The appointment as note trustee and the terms and conditions of such appointment are provided for in the trust deed, which is the document pursuant to which the debt securities are issued by the SPV and which will set out the terms and conditions applying to such securities. In a pre-enforcement scenario the role of a security trustee is limited to considering and – if deemed appropriate – granting requested waivers and approvals for amendments to the transaction documentation.[49] In a post-enforcement scenario one would expect the security trustee to become more active, particularly if it is requested by the investors to enforce the security.

In Dutch RMBS the security trustee would typically take the form of a Dutch foundation (*stichting*). Similar to the (shareholder of a) SPV it has a limited business purpose and is set up as a bankruptcy remote vehicle. The security trustee is usually set up and managed by a corporate services provider. The corporate services provider must be independent from the originator and should not be the same legal entity as the director of the SPV or its shareholder.

7.4 SELECTED LEGAL ISSUES

7.4.1 ENFORCEMENT OF SECURITY

As set out in paragraph 7.2 above, the assets of the Dutch SPV are generally limited to receivables and other contractual rights over which a right of pledge is created by the SPV in favour of the security trustee as security for the parallel debt.

A pledge of receivables can be enforced under Dutch law by way of collection (*inning*) of the related payment either through (a) in respect of undisclosed rights of pledge, notification of the pledge to the debtor of the receivable (and until such notification the pledgor is authorised to collect the receivables and the debtors can continue to validly discharge their debts by paying to the pledgor); or (b) in respect of disclosed rights of pledge, termination of the authorisation that may have been given by the pledgee thereunder to the pledgor to collect the receivables, after which the debtors can only validly discharge their debts by paying to the pledgee.[50]

As set out above, notification of the pledge (or revocation of the authorisation to the pledgor to collect the receivables) will usually only take place upon the occurrence of a default at SPV level (e.g., failure to pay amounts due under the debt securities issued by the SPV, insolvency of the SPV or breach of material covenants of the SPV under the transaction documents). The pledgee can also foreclose (*uitwinnen*) the pledged receivables by selling such receivables, provided that there is a default (*verzuim*) in the obligations secured thereby.[51] This sale must take the form of a public auction or – with approval of the competent court – a private sale.[52] A foreclosure of rights of pledge by way of a foreclosure sale may be particularly relevant in circumstances where the pledged receivables have long maturities (e.g., residential mortgage loans).

7.4.2 IMPACT OF INSOLVENCY ON SECURITY

Registration of a deed of pledge (in case of an undisclosed right of pledge) and notification of a deed of pledge to a debtor of a receivable (in case of a disclosed right of pledge) after the Dutch SPV has been declared bankrupt (*failliet verklaard*) or has become subject to a suspension of payments (*surseance van betaling*) (insolvency proceedings), will not be effective and, consequently, in such event the receivables will not have been validly pledged in favour of the security trustee.[53] In respect of payments under pledged receivables made to the Dutch SPV following notification to the debtors of the assignment of the receivables to the Dutch SPV but prior to notification to the debtors of the pledge and prior to the Dutch SPV having been subjected to insolvency proceedings, and not on-paid to the pledgee prior to the insolvency of the Dutch SPV, the security trustee (as pledgee) will be an ordinary, non-preferred creditor, having an insolvency claim (*voor verificatie vatbare vordering*). In respect of post-insolvency payments, the pledgee will be a preferred creditor having an insolvency claim.[54] Creditors of insolvency claims have to share in the general insolvency costs and have to await finalisation of a (provisional) distribution list (*(voorlopige) uitdelingslijst*).[55]

A security trustee can, in the event of insolvency proceedings involving the Dutch SPV, exercise its rights as pledgee as if there were no insolvency proceedings.[56] However, if the Dutch SPV is subject to insolvency proceedings, the position of the security trustee as pledgee would be affected in some respects, the most important of which are, that:

(a) a mandatory 'cool-off' period (*afkoelingsperiode*) of up to four months may apply in the case of bankruptcy or suspension of payments involving the Dutch SPV (applicable in respect of each procedure), which, if applicable, would delay the exercise of enforcement rights under the right of pledge. However, such cool-off period does not prevent the pledgee from giving notice to the debtors of any pledged receivables and collecting the proceeds but it will prevent the pledgee from taking recourse against any amounts so collected during such period; and

(b) the security trustee could be obliged to enforce its rights of pledge within a reasonable period as determined by the judge-commissioner (*rechter-commissaris*) appointed by the court in the case of bankruptcy of the Dutch SPV, failing which the bankruptcy receiver (curator) will be entitled to sell the pledged receivables or assets. In such case, the pledge will receive payment prior to ordinary, non-preferred creditors having an insolvency claim but after creditors of the estate (*boedelschuldeisers*).

To the extent that rights purported to be pledged by the Dutch SPV to the security trustee under the Dutch pledge agreements are future rights (*toekomstige vorderingen*), such rights are no longer capable of being pledged after insolvency proceedings involving the Dutch SPV taking effect. For example, amounts from time to time credited to a Dutch SPV's bank account held in the Netherlands are regarded as future rights and a right of pledge thereon will only become effective at the time the amount is credited to the bank account. If an amount is credited to such bank account after insolvency proceedings involving the Dutch SPV taking effect, such amounts would not become subject to the pledge and would fall in the insolvent estate of the Dutch SPV.[57]

[1] This general overview is, with permission, prepared on the basis of a publication on Securitisation in 2010 by R.E.G. Masman and P.N.J. van Welzen, attorneys at law at Clifford Chance LLP, Amsterdam. This general overview has been updated in May 2015 with input from R.E.G. Masman and P.N.J. van Welzen. This general overview does not necessarily deal with every important topic nor cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice. Neither the DSA nor any other person assumes any responsibility or accepts any liability for the content of this general overview.

[2] They do not purport to give an exhaustive summary or description of all relevant issues that one can come across in structuring a securitisation transaction.

[3] Regulation (EU) No 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) No 648/2012 (CRR).

Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (AIFMR).

Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies (CRAIII).

Regulation (EC) No 24/2009 of the European Central Bank of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions, which is replaced by Regulation (EU) no 1075/2013 of the European Central Bank of 18 October 2013 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitisation transactions (recast) (ECB/2013/40) (ECB Regulation).

[4] See websites: www.dutchsecuritisation.nl and www.pcsmarket.org.

[5] Often the note trustee (or the security trustee if its function as note trustee is combined with holding the security interests for the benefit of the investors) will only agree to these changes if the credit rating agencies have indicated that such changes do not adversely affect the credit ratings of the debt securities.

[6] The minimum content of such information and the form in which such information is to be delivered to investors is prescribed by regulatory laws and industry bodies. See also footnote 3 above.

[7] These reports can be found on the websites of the credit rating agencies.

[8] Although a legal transfer of the assets is intended, the accounting treatment from the originator's perspective may be different in respect of the assets and, consequently, such assets may remain on the balance sheet of the originator.

[9] Credit rating agencies will not completely ignore the originator's credit risk in a true sale transaction given that the originator, amongst other things, is likely to have certain repurchase obligations in relation to the assets (e.g., as a result of a breach of the eligibility criteria). If the originator is not able to repurchase ineligible assets if required, this may result in losses to the investors.

[10] Furthermore, the diversity of investors may increase when a range of acceptable risk profiles in the relevant debt securities are obtained.

[11] In some Dutch domestic transactions a Dutch foundation (*stichting*) is used as an SPV, usually for tax reasons. There is also flexibility for using foreign SPVs in Dutch domestic transactions. The choice of jurisdiction is often primarily driven by tax reasons. Since the inception of the European ABS market, on the basis of a favourable Dutch tax (treaty) position, Dutch SPVs have commonly been used as issuing vehicles in both Dutch domestic transactions as well as cross-border transactions.

[12] Section 1 Dutch Bankruptcy Act (*Faillissementswet*).

[13] Generally, there are also limitations on the right of the SPV (and its management) to petition for its insolvency.

[14] It remains to be seen whether in the future this exemption can still be used, which primarily depends on the meaning of the definition of "public" as used in CRR, which is yet to be clarified by the European Banking Authority.

[15] Section 3:5(2d) FSA.

[16] Section 3(2) Definitions Decree FSA (*Besluit definitiebepalingen Wft*). If the aggregate facility amount and minimal drawdown amount are less than EUR 100,000 the SPV can still borrow monies under normal loan facilities from lenders provided that such lenders (otherwise) qualify as professional market party (*professionele marktpartij*) (e.g., a licensed bank) within the meaning of s. 1:1 FSA.

[17] Section 2:60 FSA.

[18] Section 3 Exemption Regulation FSA (*Vrijstellingsregeling Wft*).

[19] It is not intended to give a complete overview of all reporting obligations that may apply to an SPV.

[20] It goes beyond the purpose of this general overview to describe these requirements in detail.

[21] Aspects of EMIR in relation to the mandatory clearing obligation and the mandatory margining requirement and its application to securitisation vehicles remain unclear.

[22] If it is also intended to transfer a party's obligations under a contract the method of contract transfer (*contractsoverneming*) should be used (s. 6:159 DCC).

[23] Section 3:94(1) DCC.

[24] Section 3:94(3) DCC. The possibility of silent assignment was re-introduced in the DCC in October 2004. Dutch domestic transactions entered into prior to October 2004 were based on a conditional assignment structure, meaning that the transfer of receivables would not be perfected until notification of the assignment is given to the debtors, to avoid that debtors would have to be notified at inception of the transaction. As a result of such conditional assignment, the SPV would become exposed to insolvency risk of the originator. To address this risk such transactions typically included a dual pledge structure pursuant to which the originator granted first and second ranking rights of pledge over the receivables to the security trustee and SPV, respectively, as security for, respectively, the originator's and SPV's obligations under the transaction documents.

[25] Section 3:84(3) DCC.

[26] This view is supported by HR 19 May 1995, *NJ* 1996, 119 (Keereweer q.q./Sogelease). In Dutch legal literature re-characterisation risk is discussed in respect of Dutch covered bond transactions: see in particular A.F. Salomons & M.G. van 't Westeinde, '*Covered bonds en het fiducia-verbod*, WPNR 6758 (2008): 453–460 and R.M. Wibier, '*Reactie op "Covered bonds en het fiducia-verbod" van Prof.mr. A.F. Salomons en mw. M.G. van 't Westeinde in WPNR (2008) 6758*', WPNR 6769 (2008): 715–717. The structure (and technique) of a covered bonds transaction is similar to (and based on) that of a true sale transaction, other than that in a covered bonds transaction: (i) the issuer of the covered bonds is the (originating) bank (instead of an SPV) whose obligations under the covered bonds are guaranteed by an SPV; and (ii) the title (*titel*) for the transfer of receivables by an originator to an SPV is that of a 'guarantee-support' instead of a sale.

[27] Section 3:83 DCC.

[28] Pursuant to s. 6:159 DCC a contract transfer (*contractsoverneming*) requires the cooperation of the counterparty unless it has given its consent in advance to such contract transfer (in which case notification of the transfer is still required for the transfer to become effective). However, such consent given in advance may not necessarily be enforceable if given by a consumer (s. 6:236(e) DCC).

[29] Pledges can also take the form of bank or credit pledges and are also generally structured as such by Dutch banks. The analysis in respect of bank and credit mortgages similarly applies to bank and credit pledges.

[30] See HR 16 Sep. 1988, NJ 1989, 10 (Onderdrecht/FGH&PHP). In legal literature the view has also been defended that a bank mortgage would only follow the receivables which it secures if the relationship between the lender and the borrower has been terminated in such a manner that, following the transfer of the receivables, the lender can no longer acquire new receivables that would be secured by the bank mortgage. See also W. Ruys, '*Securitisation en bankhypotheken: problemen en mogelijke oplossingen*', in *Onderneming en effecten*, ed. S.C.J.J. Kortmann et al., vol. 13 of serie *Onderneming en Recht* (Deventer: W.E.J. Tjeenk Willink, 1998), 511–524. In line with this view, Dutch residential mortgage-backed transactions typically provided for a partial termination of the bank mortgage by the lender to the extent that it related to receivables that were not securitised. However, in line with the widely accepted view that a mortgage right as dependent right in principle follows the receivable it secures, this is no longer considered necessary. See also L. Timmerman, '*Bankhypotheek en afhankelijkheid*, in *Onderneming en 10 jaar nieuw*

burgerlijk recht, ed. S.C.J.J. Kortmann et al., vol. 24 of *serie Onderneming en Recht* (Deventer: Kluwer, 2002), 411–424.

31 Sections 3:166 et seq. DCC.

32 For example, s. 3:170(3) DCC.

33 HR 11 Mar. 2005, *JOR* 2005, 131. See also S.C.J.J. Kortmann, '*Inning van andermans gesecureerde vordering*', *TvI* (2005/19): 67–69.

34 Sections 23 and 35 Dutch Bankruptcy Act (*Faillissementswet*).

35 Section 2:7 DCC.

36 Sections 3:45 et seq. DCC (pre-insolvency) and ss 42 et seq. Dutch Bankruptcy Act (*Faillissementswet*) (post-insolvency), respectively.

37 A waiver of statutory set-off rights by a consumer may not necessarily be enforceable (s. 6:237(g) DCC).

38 Section 6:127 DCC.

39 Section 6:130 DCC.

40 *TM Parl. Gesch.* Book 3, 314.

41 M.P. van Achterberg, *Overgang van vorderingen en schulden en afstand van vorderingen*, vol. B44 of Mon. *Nieuw BW* (Deventer: Kluwer, 1999), 11.

42 See B. Wessels, *Achtergestelde vorderingen*, vol. 6 of *Mon. Privaatrecht* (Deventer: Kluwer, 2006).

43 See e.g. article 405 CRR, article 51 AIFMR and article 135 of the Solvency II Framework Directive (2009/138/EC).

44 Sections 3:166 et seq. DCC.

45 See S.C.J.J Kortmann, M.H.E. Rongen & H.L.E. Verhagen, 'Zekerheidsrechten op naam van een "trustee" (I)', *WPNR* 6459 (2001): 813–823 and S.C.J.J Kortmann, M.H.E. Rongen & H.L.E. Verhagen, 'Zekerheidsrechten op naam van een "trustee" (II, slot)', *WPNR* 6460 (2001): 840–846, who argue that there is no reason for such uncertainty.

46 There are other alternatives available (e.g., a surety structure (*borgtocht-constructie*) and a joint creditorship (*actieve hoofdelijkheid*) structure). However, in the Dutch syndicated loan and capital markets a parallel-debt structure is generally considered to be the most efficient structure with which investors have become familiar.

47 See also S.C.J.J Kortmann, M.H.E. Rongen & H.L.E. Verhagen, 'Zekerheidsrechten op naam van een "trustee" (II, slot)', WPNR 6459 (2001): 819.

48 Sections 3:227 et seq. DCC.

49 The market turmoil and other circumstances have resulted in a number of credit rating downgrades of debt securities in securitisation transactions and credit rating downgrades of participants in such transactions (e.g., liquidity and swap providers). These events and other credit related events have resulted in a more active involvement of security trustees in some securitisation transactions.

50 Section 3:246 DCC.

51 Section 3:248 DCC.

52 Sections 3:250 and 3:251 DCC.

53 Sections 23 and 35 Dutch Bankruptcy Act (*Faillissementswet*).

54 HR 17 Feb. 1995, *NJ* 1996, 471 (Mulder q.q./CLBN).

55 Section 182 Dutch Bankruptcy Act (*Faillissementswet*).

56 Section 57 Dutch Bankruptcy Act (*Faillissementswet*).

57 Sections 23 and 35 Dutch Bankruptcy Act (*Faillissementswet*).