

The International Comparative Legal Guide to:

Securitisation 2005

A practical insight to cross-border Securitisation Law



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1 Choice of Law

1.1 If the seller and the debtors are resident in your country, and the transactions giving rise to the receivables and the payment of the receivables take place in your country, can the seller and the debtor choose a different country's law to govern the receivable contract and the receivables?

Under Czech conflict of laws rules, there must be a “foreign element” (i.e. a non-Czech element) to the relationship in order for a different country's law to govern the receivable contract and the receivables. Typically, this refers to the residence of one of the parties or the location of the subject matter. In the described situation, there seems to be no foreign element and therefore Czech law would have to apply.

1.2 If your country's law governs the receivables, and the seller sells the receivables to a purchaser in another country, can the seller and the purchaser choose the law of the purchaser's country or a third country to govern their sale agreement?

Yes, they can certainly choose the law of the purchaser's country as the governing law. Generally, as a matter of Czech law, they may even choose the law of a third country for this purpose, provided that such law is not chosen (primarily) to avoid the application of Czech law. In any case, the parties cannot exclude the application of the imperative rules of Czech law.

1.3 In the case described in 1.2 above, will your country's laws apply to determine (i) whether the sale of receivables is effective as between the seller and the purchaser, (ii) whether the sale is perfected, (iii) whether the sale is a true sale, and/or (iv) whether the sale is effective and enforceable against the debtors?

- (i) No, the law of the contract will apply.
- (ii) No, as above.
- (iii) Yes, in the course of the Czech bankruptcy proceedings of the seller; Czech voidance rules will apply in particular (see answers to sections 4 and 6 below).
- (iv) No, as under (ii).

2 Receivables Contracts

2.1 Can a receivable be sold without the debtor's consent if the receivable contract does not prohibit assignment?

Under Czech law, such a sale is possible, but in order to be perfected (i.e. effective vis-a-vis the debtor), it must be notified (or proven) to the debtor (see answers to questions 3.1 and 3.3 below).

2.2 If the receivable contract does prohibit assignment, will the sale of receivables be ineffective and/or give the debtor the right to sue the seller and/or the buyer?

The sale will be void (and therefore also ineffective).

2.3 Do your country's laws limit rates of interest on consumer credit, loans or other kinds of receivables?

Interest on consumer credit has to be calculated in the manner prescribed by law and according to the rate and change mechanism stated in the contract. There is not, however, any limit on the rate as such.

There is no other explicit regulation in this regard.

The general principles of Czech law regarding good moral conduct and restraint from unfair commercial practices will, however, apply in this situation. Accordingly, if the interest is excessively high, it may be contrary to these principles and therefore unenforceable.

3 Asset Sales

3.1 In your country what is necessary generally in order for a seller to sell accounts receivable to a purchaser and for the sale to be perfected?

A written assignment contract must be executed by the purchaser and the seller; in addition, the seller must either give notice of the sale to the debtor or the purchaser must prove to the debtor that the sale took place.

An assignment (sale) is not possible if the receivable is personal to the seller or if the contract between the debtor and the seller excludes such a sale.

3.2 What additional or different requirements apply to sales of promissory notes, mortgage loans, or marketable debt securities?

Promissory notes that are order papers need to be endorsed. Promissory notes which are not order papers are simple receivables which are transferable (assignable) by contract.

Mortgages are accessory rights under Czech law and therefore pass automatically with the receivable which they secure. As a matter of practice, however, notification of the sale to the security provider (if a different person to the debtor) and entry of the change in the Cadastral Register are common.

The requirements for the sale of debt securities are as follows:

- a) in case of book-entered securities: registration of the sale with the central depository; and
- b) in case of securities in documentary form: (i) endorsement if they are order securities and (ii) handover if they are bearer securities.

3.3 Must the seller or the purchaser notify debtors of the sale of receivables in order for the sale to be effective against the debtors, that is (i) to allow the purchaser to enforce the debts directly against the debtors, (ii) to prevent the debtor and the seller from amending the receivable contract without the purchaser's consent, (iii) to prevent the debtor from setting off receivables against any obligations of the seller to the debtor, or (iv) to require the debtors to pay the purchaser rather than the seller?

Yes. In order to make a sale of receivables effective vis-à-vis the debtor, either the seller must notify the sale (assignment) to the debtor or the buyer must prove such sale to it (e.g. by providing a copy of the purchase agreement). This has the following effects:

- (i) It allows the purchaser to enforce the debts directly.
- (ii) It does not prevent the debtor and the seller from amending the receivable contract without the purchaser's consent.
- (iii) It prevents the debtor from setting off receivables against obligations of the seller to the debtor which have arisen after the notification (or proof); the set-off of already arising obligations is not affected, provided that the debtor notifies the buyer of the same without delay upon the notification (or proof) of the sale.
- (iv) It requires the debtor to make payment(s) to the purchaser; payment to the seller will not release the debtor from its obligation corresponding to the receivable.

4 True Sale

4.1 In general, what is necessary for a sale of receivables to be a true sale? Among other things, to what extent may the seller retain credit risk, interest rate risk, or control of collections on receivables?

It is necessary to distinguish true sales as a matter of law and true sales for accounting and tax purposes. A legal true sale

requires only the satisfaction of the conditions described under section 3 above, subject to the bankruptcy challenges described under section 6 below.

4.2 Can there be a true sale of receivables that do not yet exist (as in a "future flow" securitisation), so that a single sale on a certain date results in the purchaser automatically being the owner of the "sold" receivables immediately when they come into existence?

The sale (assignment) of receivables that do not yet exist is generally contentious under Czech law. It is a legal requirement that the receivables which are being assigned be identifiable. On the other hand, the law does not exclude the assignment of future receivables and conditional receivables. The reconciliation and limits of these principles are not sufficiently dealt with by authoritative case law. Therefore, any future receivable assignment - even outside the context of securitisation - must resolve this issue with respect to the particular circumstances of the given case. The prevailing view seems to be that future receivables arising under one specific contract, such as a leasing contract where the amounts are known at the beginning or are at least calculable based on the contract, may be assigned through one single sale at the outset. However, any receivables which may or may not arise under a framework (for example, a purchase) agreement or overall business arrangement are not. In these latter cases, it is typical to periodically assign the receivables as they arise.

Given this situation, the Czech Republic's Home Credit securitisation, the only public securitisation in the country to date, made use of daily assignments of consumer credits to avoid the "identification risk".

4.3 Do your country's laws have any "safe harbour" provision for treating a sale as a true sale? If so, what is required?

There are no "safe harbour" provisions.

5 Security Interests

5.1 What is necessary for the purchaser to grant a security interest in accounts receivable under the laws of your country and for the security interest to be perfected?

The security interest may be granted by a simple contract between the purchaser and the security taker. Czech law, requires, however, that the secured claim belong to the security taker at the time that the security is created, i.e. the security cannot (without further structuring) be provided to a third party trustee to secure the claims of any other person(s).

5.2 What additional or different requirements apply to security interests in promissory notes, mortgage loans, or marketable debt securities?

The following additional requirements apply to the granting of security interests in:

- (i) Promissory notes: a security endorsement.
- (ii) Mortgage loans: none; see answer under question 3.2 above.
- (iii) Debt securities:
 - a) in case of book-entered securities, registration with the central depository; and
 - b) in case of securities in documentary form, (i) security endorsement if they are order securities and (ii) handover if they are bearer securities.

5.3 If the purchaser grants a security interest in the receivables under the laws of the purchaser's country or a third country, and that security interest is valid and perfected under the laws of that other country, will it be treated as valid and perfected in your country?

In principle, such security would be valid and perfected unless there is a reason (such as imperative provisions of Czech law or public policy) for not giving it effect, and provided that its effects correspond to the effects of valid security instruments under Czech law. It should be noted, however, that there is considerable uncertainty as to how such a security would be treated (for example, in case of Czech bankruptcy or enforcement), and therefore its use is typically avoided. Moreover, any security over immovable property (under Czech law, buildings and land are both considered to be immovable property but are treated as separate objects) should be created under a Czech law-governed mortgage agreement.

6 Insolvency Laws

6.1 If after the sale of receivables the seller becomes subject to an insolvency proceeding, will your country's insolvency laws prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the receivables ("automatic stay")? Does the answer to this question (or the questions below) depend on whether the sale is a true sale?

The answer differs depending on whether the sale is a true sale or one understood as a secured loan:

1. In case of a true sale, there is no automatic stay and the purchaser will be able to collect, transfer or exercise any other rights over the receivables.
This applies as a matter of law even if the (insolvent) seller is collecting the receivable.
However, under Czech insolvency law, all assets which the bankruptcy administrator records on the bankruptcy estate list will be part of the bankruptcy estate until removed through the final decision of a competent court, and no person may deal with such assets. The current practice of bankruptcy administrators is to record even those assets which do not belong to the bankruptcy estate on the bankruptcy estate list, and then let the litigation take its course. Bankruptcy proceedings, including such litigation, take approximately 4 years. Therefore, for practical rather than legal reasons, the commingling risk should be taken into consideration.

2. If the sale is not a true sale, but rather a loan and security assignment of the receivables, such transaction will be treated like any other security given by the seller, and the purchaser will have the standing of a secured creditor, subject to some uncertainty about whether a security assignment under non-Czech law would be recognised in Czech bankruptcy proceedings.

Secured creditors are entitled to 70% of the net bankruptcy proceeds, which is allocated to them for the realisation of their security. The remaining 30% of the proceeds is then distributed among all unsecured creditors and any secured creditors whose claims (if any) have not been fully satisfied from the initial distribution.

6.2 If there is no automatic stay, could the insolvency official prohibit exercise of rights by the purchaser by means of injunction, stay order or other action?

Any asset can be included in the bankruptcy estate by its mere listing by the bankruptcy administrator. Following this, no-one else may deal with such asset until a court decides on whether it belongs to the bankruptcy estate.

6.3 Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

This is not possible under Czech insolvency law.

6.4 Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding?

Any security interest given by the seller to its creditor during the last two months before the filing of the application for the bankruptcy declaration will become invalid following the bankruptcy declaration.

The bankruptcy administrator can rescind transactions that took place in the last six months before the filing of the application for the bankruptcy declaration if the transaction was under value or the bankrupt assumes unreasonable obligations thereunder. He can also rescind transactions that took place in the three years before such declaration if they were performed with an intention to defraud creditors and this intention must have been known to the other party.

6.5 Can an insolvency official reject or rescind any of the seller's obligations (such as warranties) under receivable contracts (thus potentially giving rise to claims against the seller that could be set off against the receivables)?

An assignment of receivables does not generally affect the obligations under the contract, which therefore remain with the seller. Accordingly, if the assignment has already been notified to the debtor, the debtor will not be able to subsequently set off its claim (for example, for breach of warranty by the bankrupt seller) against the assigned

receivable. Without such notification, such set-off would be possible unless and as long as the receivable is included in the bankruptcy estate (see question 6.4 above).

It should also be noted that under Czech bankruptcy rules, the bankruptcy administrator and the counterparty of a reciprocal agreement (synallagmatická smlouva) which has not yet been fully performed by the effective date of the bankruptcy declaration may each unilaterally rescind such agreement. This adversely affects the possibility of securitising certain assets, such as leasing receivables.

7 Special Purpose Entities

7.1 Does your country have laws specifically providing for establishment of special purpose entities for securitisation? If so, then what is required and what legal attributes and benefits will the entity have?

Czech law has no special securitisation or other legislation which would provide particular arrangements to accommodate the needs of SPV companies.

7.2 If an agreement with a special purpose entity provides that the other parties will not take legal action against it or that they will not commence an insolvency proceeding against it, is that provision valid and enforceable?

Czech law contains an old-fashioned and rigid rule that an entity cannot give up its rights before they arise. This applies not only in consumer or similar “uneven” relationships but also in commercial dealings among equally strong and sophisticated parties. In such relations, the rule has little justification, and it, of course, creates legal uncertainty in structured transactions.

As a result of this rule, non-petition and similar clauses are difficult to rely on. On the other hand, if included in a contract governed by non-Czech law, they will not necessarily be against public policy, in particular, if agreed upon among equally strong parties.

7.3 If the organisational documents or agreements of a special purpose entity provide that the directors or managers will not commence an insolvency proceeding involving the entity unless required under applicable law, is that provision valid and enforceable?

A similar analysis applies as in question 7.2 above. Moreover, the directors have a general duty of care towards the company as such. Therefore, such provision would most likely be unenforceable under Czech law.

8 Regulatory Issues

8.1 Does your country have laws restricting the use or dissemination of data about or provided by debtors? If so, do these laws apply only to consumer debtors or also to enterprises?

Data protection issues arise only in transactions where the underlying debtors are individuals (i.e. not legal entities);

these are typically RMBS or consumer credit transactions.

In addition, specific regulation exists regarding bank secrecy. This issue arises if bank assets are securitised, irrespective of whether the debtors are individuals or legal entities. The Czech bank secrecy regulation is far from satisfactory. Strictly interpreted, it stipulates that Czech banks may not provide information about their customers - even in connection with the assignment of receivables - without such customers’ consent. However, it is clear that in practice, such information is regularly provided. The justification for this is that bank secrecy rules cannot prohibit banks from carrying on activities which are in their legitimate interest, such as the assignment of receivables.

8.2 If the debtors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of your country? Briefly, what is required?

For a mere receivable assignment, there should not be any specific consumer protection law requirements. There are, however, specific risks associated with the assignment of consumer credits. These relate mainly to the following: (i) cash flow - consumer credits may be prepaid at any time without extra costs and the costs related to the credits must be equitably reduced; (ii) damages claims if the supplier is the exclusive agent of the consumer credit provider (this may lead, in particular, to the set-off of the receivable against the claim for damages under certain circumstances if the assignment has not been notified to the consumer (debtor)); (iii) the requirement that there be a fair settlement among the credit provider, the supplier and the consumer if the consumer returns the purchased goods; and (iv) the fact that all defences, including set-off, which were available to the consumer (debtor) against the assignor (seller) prior to the consumer’s notification of the assignment may be pleaded against the assignee (the purchaser). Although this is a general principle of Czech assignment law, it may be particularly relevant in the context of consumer credits.

8.3 Assuming that the purchaser does no other business in your country, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any license or its being subject to regulation as a financial institution in your country?

If the purchaser is not collecting the receivables itself, it will not be required to qualify to do business in the Czech Republic. The answer may be different if the purchaser itself does the collecting and enforcement activities, but that is not typically the case.

The acquisition of receivables and their collection and enforcement do not require a financial institution licence.

8.4 Does your country have laws restricting the exchange of your country’s currency for other currencies or the making of payments in your country’s currency to persons outside the country?

No, however in the event of a monetary crisis, a moratorium on such exchange or payments, and/or deposit obligations may be imposed.

9 Taxation

9.1 Will any part of payments on receivables by the debtors to the seller or the purchaser be subject to withholding taxes in your country? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

The payments by the debtors to the servicer and the payments of the collections by the servicer to the purchasers will not be subject to any withholding tax in the Czech Republic, provided that:

- (i) If the purchaser resides outside the Czech Republic, the income on the portfolio (after the deduction of all related expenses) shall be deemed to be Czech income (irrespective of whether the purchaser has a permanent establishment or place of effective management in the Czech Republic and whether the seller services it) and will be taxable at the standard corporate income tax rate in the Czech Republic.
- (ii) If such purchaser is not a resident for tax purposes of an EEA member state, and the Czech Republic has not concluded a double taxation treaty with its resident state stipulating otherwise, a 10% deposit for tax liabilities should be deducted from the portfolio payments to the purchaser. However, the operation of this Czech law provision in practice is very unclear.

9.2 Does your country impose stamp duty or other documentary taxes on sales of receivables?

The Czech Republic does not impose stamp duty or other documentary taxes on sales of receivables.

9.3 Does your country impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Generally, such taxes are imposed, however,

- (i) the sale of receivables will not be subject to VAT in the Czech Republic (although the reasons for this differ depending on whether the receivables were originated by the seller or purchased by it); and
- (ii) in case of the servicing of the receivables (whether effected by the seller or a back-up servicer), if the purchaser is not a resident of the Czech Republic, then provided that

the servicing of the portfolio can be classified as “financial services”, the place of the provision of services will not be the Czech Republic, and therefore, Czech VAT regulations will not apply.

9.4 If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims against the purchaser or on the receivables or collections for the unpaid tax?

See answer under question 9.1. above regarding security and tax; otherwise these claims are not applicable.

9.5 Assuming that the purchaser conducts no other business in your country, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the debtors, make it liable to tax in your country?

See answer under question 9.1 above. If the purchaser is a resident in the Czech Republic, it will be taxed in the same manner as any Czech operating company; no special regime applies.



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