Although the Czech Republic has no specific securitisation law, and although it has been remarked that without the necessary legislative changes securitisations are unfeasible in the Czech Republic, in fact securitisations in the Czech Republic are possible even under the existing legislative framework.

Despite misgivings as to the allegedly insufficient volumes of assets to be securitised, the availability of cheap local bank financing and legal obstacles, there have been several securitisation transactions in recent years, including a true-sale securitisation conducted by Home Credit a.s. for over Kr2.847 billion (and a total programme volume of Kr4.15 billion) in 2003 and a synthetic securitisation (an unfunded multi-originator balance sheet collateralised loan obligations) conducted by Raiffeisenbank a.s. and Raiffeisen Bank Polska SA in 2006, which amounted to €450 million. The securities issued within the framework of the Home Credit securitisation in 2006 were listed on the Irish Stock Exchange; the initial principal amount of the Class A and Class B securities was Kr4.783 billion.

The continuing rise in consumer and commercial lending (particularly in the real estate sector), the improvement of legislation, the accession of the Czech Republic to the European Union and increasing market awareness will all contribute to the growth of securitisation in the Czech Republic.

**True-sale securitisations**

**Czech law**

At first glance Czech law is not ideal for structured finance transactions. There is no special securitisation legislation and, therefore, it is necessary to rely on general law.
Czech law can be classed as a still-developing continental legal system. However, in recent years the situation has improved significantly and, following the Czech Republic’s accession to the European Union in 2004, this trend should continue. For example, a new insolvency law, which introduces the insolvency register and materially improves the position of secured creditors, has been approved by the Parliament and published in the official collection of laws. From January 1 2008 it should replace the much criticised existing bankruptcy legislation, dating from 1991.

**Location of special purpose vehicles**
No specific Czech law facilitates or provides for more favourable treatment of special purpose vehicles (SPVs) in securitisations.

To overcome this and other legal issues (eg, the inability of Czech law to regulate asset-backed transactions and the difficulties with issuing asset-backed securities under the securities law), foreign SPVs have been preferred to date.

The Czech Republic has a good range of double taxation treaties and minimal regulations concerning foreign exchange transactions. Therefore, SPVs can be incorporated in more favourable jurisdictions (eg, the Netherlands) and need not be exposed to taxes such as withholding tax.

**True sale**
Transferring Czech law-governed assets in the form of receivables is achieved by means of assignment.

If the assignment agreement between the originator and the SPV is governed by Czech law, it must be in writing and the receivables must be sufficiently specified. In general, no extra perfection action is needed in respect of granted security because the rule is that the security follows the assigned receivable.

The doctrine of contractual freedom under Czech law is restricted by strong prohibitions on future rights. As a result, waivers, non-petition clauses and other similar clauses are likely to be scrutinised by the Czech courts.

However, it is possible (subject to the limitations under the Rome Convention 1980) to choose another law to govern the assignment agreement between the originator and the SPV depending on preference, familiarity or legal certainty.

Irrespective of the choice of governing law of the assignment agreement, the law governing the relevant asset (receivable) will determine whether (and when) the receivable is assignable and how the assignment is effected regarding third parties.

*Which receivables are assignable?*
In general, Czech law-governed receivables are assignable without the debtor’s consent.

However, certain receivables are not assignable. These include:

- personal receivables that terminate on the death of the creditor;
- receivables whose content would change if there were a change of creditor;
- receivables that are excluded from assignment by contract between the debtor and the creditor; and
- receivables that are prohibited from being assigned by Czech law (this is rarely the case).

The assigned receivables must be specifically identified (ie, individualised) to the extent that they cannot be confused with another receivable.

*Assignment of future receivables*
The Civil Code does not expressly provide for the assignment of future receivables. Nevertheless, practice and doctrine agree that the assignment of future receivables is possible, subject to the specific identification of the receivables concerned. Furthermore, assignment of future receivables becomes effective under Czech law only when the relevant receivable comes into existence (and not when the assignment agreement is executed). In the Home Credit securitisation this situation was addressed by the daily assignment of new receivables; combined with the Czech electronic signature legislation, this solved the problem satisfactorily.
Action regarding the originator’s debtors

An existing receivable is assigned at the time at which the assignment agreement is executed and becomes binding upon both parties.

An assignment is not effective regarding the debtor until it is so notified by the assignor or until the assignee proves that the receivables have been assigned (e.g., by providing a copy of the relevant agreement). Until then, the debtor is required to continue to discharge its debt to the original creditor; alternatively, the debtor can also offset its receivables against the obligations of the assignor towards the debtor which have arisen before the notification.

This notification must be made without undue delay, although if this requirement is not satisfied the law does not provide any penalties for non-compliance. There is also no requirement under Czech law to send the notification in writing.

In the Home Credit securitisation all the originator’s debtors were notified of the assignment.

Law of security

As the Czech Republic is a typical continental jurisdiction, the law makes it problematic to take security over future assets.

With the exception of the limited circumstances in which financial security can be taken over financial instruments and cash, the following situation applies. Secured creditors are required to enforce their collateral through either court action or a public auction. Foreclosure, or any other act whereby a creditor immediately acquires ownership title to the secured assets, is not permitted and any such legal arrangement is unenforceable in the Czech Republic.

Czech bankruptcy law does not permit secured creditors to control directly the process of enforcement or to appoint a receiver or administrator at their sole discretion. The debtor’s assets that are subject to security interests will be sold by the bankruptcy administrator. Secured creditors are entitled to receive a part of the proceeds of the sale.

In the event of bankruptcy the secured creditors will be entitled to receive only up to 70 per cent of the proceeds of the sale of their security in priority to other creditors (minus the costs of maintenance and the sale thereof). The rest of their claim (if any) will be settled on equal terms within the general category of unsecured creditors.

The rights of separate settlement pertaining to security interests perfected in the two months before the filing of a bankruptcy petition or thereafter will automatically terminate upon the declaration of bankruptcy.

No security was taken directly over the Czech assets in the Home Credit securitisation. Instead, certain SPVs within the structure created security interests in the notes they purchased from other SPVs.

Bankruptcy remoteness – clawback provisions in the bankruptcy

Six-month period

Certain transactions carried out in the six months before the filing of a bankruptcy petition or thereafter will automatically become ineffective regarding the creditors. This means that consideration from these transactions must be returned to the bankruptcy estate. Transactions falling within this six-month period include:

- the formation of companies or other legal entities;
- the acquisition of shares in companies or cooperatives;
- the transfer of assets without consideration or on manifestly disadvantageous terms; and
- transactions whereby the debtor enters into obligations disproportionate to its assets.

No element of preference or undervalue must be present in relation to transactions mentioned under the first, second and fourth bullet points above.

Three-year period

In addition, the bankruptcy administrator and all creditors may bring suits to avoid transactions entered into by the debtor in the previous three years; here, the bankruptcy administrator or the creditor must prove that:
the transaction was prejudicial to the creditors;
the debtor acted with the intention of causing such prejudice; and
the other party was aware of such intention.

Withdrawal
The bankruptcy administrator and creditors have the power to withdraw from contracts that have not been fully performed by either party or contracts that have been only partly performed. However, the law is silent on the effects of such withdrawal. If the contract is governed by Czech law, the effect of the withdrawal from a partly performed contract may be quite disastrous for the creditor - the creditor may be obligated to return all consideration received from the debtor to the bankruptcy estate and file proof of an unsecured claim for the return of all consideration provided by it to the debtor.

Applicability of Czech bankruptcy law
The Czech courts recently confirmed that a company incorporated in the Czech Republic could be subject to proceedings in accordance with the UK Insolvency Act 1986. The jurisdiction of the UK courts over a Czech person was based on the EU Insolvency Regulation (1346/2000), which applies when a company’s centre of main interests is outside the Czech Republic in another EU member state.

Recharacterisation and consolidation
In the event of an originator’s bankruptcy, the recharacterisation of the assignment (expressed as an outright sale) as a secured transaction is unlikely.

There is no concept of consolidation in Czech bankruptcy law; in the event of bankruptcy, the accounts of the originator and its affiliates will not be consolidated in order to satisfy the originator’s debts.

Data protection
Data protection legislation applies only to data regarding individuals (and not to legal entities such as corporates). Therefore, if underlying debtors are companies, the transfer of their data falls outside the scope of this legislation.

On the other hand, if securitisation concerning processing data pertaining to individuals is sought (eg, credit card receivables), compliance with the data protection legislation is required for the transfer and processing of individuals’ personal data to an SPV. The Czech Data Protection Office has indicated that this should not be an issue when the data stays within the European Union.

Bank secrecy
These requirements are applicable only when a bank’s assets are subject to securitisation. The Czech banking legislation stipulates that all banking business information, financial service information and information on bank account statements is subject to bank secrecy. This applies to both individuals and legal entities. This duty of confidentiality ceases to apply if the customer consents to such disclosure or when a statutory exemption applies (disclosure in connection with assignments is not a specific exemption). There is a special limited exemption from bank secrecy in respect of non-performing loans.

Analogous rules exist in relation to insurance companies where there is a specific exemption for ‘transacting in its receivables’.

Home Credit securitisation
Home Credit was looking for a way to help fund its growth with alternative sources of financing outside the Czech Republic to complement funding from its parent company and domestic financing. The main features are as follows:

- The Class A securities were rated A2 by Moody’s and A by Standard & Poor’s, and the Class B securities were rated Baa2 by Moody’s.
- The securities were denominated in Czech koruna and listed on the Irish Stock Exchange.
- The documentation was governed by Czech, Dutch and English laws.
- Various SPVs used in the financing structure were incorporated in the Netherlands.
The key question of how to assign future receivables was resolved in a conservative manner. The daily flow of new credit card receivables is assigned on a daily basis. To facilitate this time-consuming method, an electronic signature was used.

Taxation

**Transfer of receivables**

The income of the originator - either a Czech tax resident or the Czech permanent establishment of the foreign originator to which the income is attributable - derived from the transfer of the receivables to the assignee is subject to a corporate income tax rate of 24 per cent. The taxable income may be reduced by either the nominal value of the transferred receivable, provided that it was the originator’s receivable, or the acquisition value of the transferred receivable, provided that the originator obtained the receivable from another person. In general, the originator may not deduct any loss incurred from the transfer of the receivables. Such tax non-deductible loss may be decreased by the bad debt provision or by a discount in the case of a receivable transferred before the maturity date.

**Settlement of receivables**

Any income paid by the Czech debtor to an assignee that is a Czech tax non-resident from the repayment of the assigned receivables is deemed to have its source in the Czech Republic and is therefore taxable in the Czech Republic at the corporate income tax rate of 24 per cent. However, the relevant tax treaty may allow the elimination of the taxation of the repayment of the receivables in the Czech Republic.

If an independent agent (eg, the originator or another person in the Czech Republic) collects the settlement of receivables for the assignee (which does not have a fixed place of business in the Czech Republic), the risk of the creation of a Czech permanent establishment of the assignee should be limited.

**Withholding tax and stamp duty**

Under Czech law there is no withholding tax or stamp duty on the transfer of receivables to an assignee that is a Czech tax non-resident, nor is there any withholding tax or stamp duty on settlement of the transferred receivables paid by Czech debtors to the assignee.

However, if the taxation of the income from the settlement of receivables is not eliminated by a tax treaty, and if the assignee is not a tax resident of either an EU member state or a European Economic Area country, Czech debtors are obliged to withhold 1 per cent of the assignee’s income from the repayment of receivables as tax security.

If the transferred receivable has the character of, for example, a loan or licence, the Czech debtors may be obliged to withhold tax payments according to the relevant tax treaty from future interest payments or licence fees arising from the transferred receivable.

**Value added tax**

No Czech value added tax applies to the transfer of receivables from the originator to the assignee.

In general, the servicing of receivables (eg, debt recovery by a Czech originator or another person for the assignee) is treated as a financial service, which is subject to 19 per cent value added tax. However, provided that the assignee is a person registered for value added tax in an EU member state or is a resident of a non-EU member state (in both cases with no fixed establishment in the Czech Republic), the place of taxable supply will be outside the Czech Republic and no Czech value added tax will apply.

**Synthetic securitisation**

The synthetic structure circumvents the jurisdiction-related problems associated with true-sale securitisations that are caused by legal and regulatory obstacles to securitisation or their low rating ceilings.

In this respect, with regard to bank receivables it is important to know whether the relevant banking regulator recognises that a credit derivative removes for regulatory purposes the relevant asset from the bank’s balance sheet. In addition, from the
synthetic securitisation perspective it is helpful that close-out netting is enforceable in the Czech counterparty’s bankruptcy.

**First synthetic securitisation**

Kreditanstalt für Wiederaufbau, Raiffeisenbank a.s. and Raiffeisen Bank Polska SA is thought to be the first banking portfolio securitisation in Central and Eastern Europe. The main features are as follows:

- The portfolio of loans to small and medium-sized enterprises in the Czech Republic and Poland is sized at €450 million, with the share of Polish loans limited to 60 per cent. In total, 1,256 loans of an average size of €360,000 have been extended to a total of 943 borrowers in the two countries. The longest maturity of the individual loans is five years.
- The originators have entered into a credit default swap with Kreditanstalt für Wiederaufbau (KfW).
- Any losses realised in the reference portfolios are compensated by KfW to each of the originators individually. KfW hedged its exposure through a series of credit default swaps: a senior credit default swap, a multiple-tranche mezzanine credit default swap and a junior credit default swap.
- The transaction involved two independent banks entering into swaps; it is structured as an unfunded transaction and does not involve an SPV.
- The capital structure comprises six tranches: €377.55 million of triple A-rated senior notes, a triple A-rated €27 million A class, an Aa2-rated portion of €7.65 million and a C and D class rated A2 and Ba2 respectively, both sized at €12.6 million. The junior non-rated equity is €12.6 million. The transaction was privately placed.
- The European Investment Fund has provided credit enhancing for the mezzanine notes and has invested in senior notes. RZB invested in the junior tranche.