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Pakistan declares interest repugnant to Islam

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Common law securitization in civil law Spain

It has not always been simple to shoehorn Anglo-American techniques into civil law jurisdictions. Sergio Nasarre-Aznar of Rovira i Virgili University, Tarragona, explains how UK securitization methods have been adapted to Spain

Mortgages are the most commonly securitized assets, in the world. In Spain, as in many continental European countries, the German system is the traditional way of financing mortgage credits. It is not based on the Anglo-American model of securitization — as the mortgages are not converted into securities, but the securities represent debt to the issuer and are covered by all the issuer's mortgages.

This model is changing for the first time since its inception in the 18th century. The European continental countries have adapted their legislation to allow other ways of land credit funding. In most cases, this involves the introduction of common law Anglo-American techniques into Latin civil law jurisdictions.

As a result, land credit is now being funded with non-traditional types of securities, such as *participaciones hipotecarias* and the *bonos de titulización hipotecaria*, which work similarly to UK mortgage-backed securities.

The common law mortgage

The UK's trust and mortgage are unfamiliar to Spanish civil law. One might think the mortgage similar to the Spanish *hipoteca*, but there are many differences that become

The Spanish mortgage is rigid and unable to be easily negotiated. Moreover, it cannot be separated into pieces

relevant in the securitization process. And the trust is almost completely unknown.

The continental mortgage has the same finality as the UK mortgage: it is used for securing the devolution of loans. When the debtor cannot refund the loan, the creditor can execute the mortgage — that is to say, take possession or foreclose for instance. But this is probably the only similarity between the two. Firstly, the UK mortgage is very flexible:

- it can be established over a piece of land or over any other thing (including moveable things);
- it may or may not be registered (a legal or equitable mortgage);
- it can take different forms (repayment mortgage, endowment mortgage, etc); and
- it allows the creditor to take possession of the land from the beginning of the mortgage's arrangement.

On the other hand, we have the Spanish mortgage, which is very rigid and unable to be easily negotiated:

- it can only be established over an immovable object or right (but not another mortgage);
- it must be registered;
- there is only one type of mortgage (art 104 Mortgage Act 1946, LH); and
- the creditor is not able to take possession of the land in any case.

Moreover, the mortgage cannot be separated into pieces — it is indivisible and it is impossible to find a legal and an equitable continental mortgage in the sense of the Anglo-American common and equity law. Finally, the continental mortgage is a dependent right over the land, which means

that it needs a credit to exist; it cannot be negotiated separately to the credit (loan) that it secures.

The UK mortgage securitization process is possible thanks to two features:

- the flexibility of the mortgage, because the credit company (building society or bank) when it securitizes is still the legal mortgagee, meanwhile the special purpose vehicle (SPV — which issues the mortgage-backed securities) has only an equitable right against the mortgagor (generally the debtor); and
- the existence of two trusts during that process.

Neither of these features are possible in a continental civil law system. Consequently the continental legislator is obliged to find other ways of achieving the same goal.

The trust

The trust is normally used twice during the English process of securitization:

- between the originator of the mortgages to be securitized (building society or bank) and the SPV: the originator is the legal owner of the mortgage and the trustee of the trust, while the SPV is the beneficiary; and
- when the SPV securitizes the mortgages, that is, when it issues the UK mortgage-backed bonds, there is a new trustee (any society) which holds the securities upon the bondholders (the beneficiaries); the finality of the trusts is to protect the issue of mortgage-backed securities from any insolvency that affects the originator or the SPV.

Although there have been initiatives to accept the trust in non Anglo-American legislations, such as the Hague's Convention on the Law Applicable to Trusts and their Recognition 1985, the trust has not been admitted in Spain, because it is not only unknown, but also incompatible with our civil law system. There are some Spanish civil law institutions that can work like the trust:

- the *mandato* (something like the English power of attorney);
- the *fideicomiso* (like a trust mortis causa); and
- the *fundación* (like a charitable trust).

However, none of these work exactly like the trust because the trust requires a division of property (legal and equitable) which is impossible in the continental civil law system — the right of the owner must always be absolute. The sale of the mortgages by the originator to the SPV is not normally complete, which produces a division of ownership between the originator (legal property) and the SPV (equitable property); then the originator (now trustee) holds the mortgages on the SPV (beneficiary) because the originator manages the mortgages, carries the relationships with the customers (debtors, mortgagors), demands the repayments of the loans, etc.

All these activities are done for the beneficiary (SPV) and for them the originator obtains a percentage of the global amount. On the other hand, the second trust appears between the SPV and the bondholders. The SPV issues the mortgage-backed securities and places the mortgages with a trustee which holds them in guaranty of the bondholders. The trustee must do

everything for the benefit of the bondholders: ensure punctual and complete interest payment by the SPV, ensure repayment of the securities in the same way if the SPV or the originator become insolvent, and so on. The issuer's trustee takes care of the bondholders' rights. If the originator becomes insolvent the trustee can order the SPV to complete the sale of the securitized mortgages, giving the SPV a legal interest over the mortgages and making it the legal creditor. If the SPV is still unable to pay the securities to the bondholders, then the trustee will be able to sell the mortgages and with this amount satisfy the bondholders.

The question then necessarily becomes, how can a continental civil law legislator manage to build a system of securitization of mortgages without these two important institutions: the English mortgage and the trust?

The mortgage securitization process in Spain

Between 1872 and 1981 Spanish land credit funding was carried out by the issuing of *cédulas hipotecarias* (mortgage bonds), which were issued exclusively by the Banco Hipotecario de España. In 1981 the Act of the Mortgage Market (LMH) introduced new legislation. Up until 1986 the *cédulas hipotecarias* were still the most important and popular securities for refunding mortgage credits. But since then they have shared their popularity with the *participaciones hipotecarias*, the securities that represent the first step to securitizing a Spanish mortgage.

The final product of the Spanish securitization process is the *bonos de titulización hipotecaria* (created in 1992). In Spanish securitizations there are, as in the English process, two main steps:

- the relationship between the originator and the SPV; and
- the relationship between the SPV and the bondholders.

They are not obviously built like a trust and they have been substituted by two Spanish civil law institutions: the partial cession of mortgage credit (art 149 LH and art 15 LH) and the Mortgage Securitization Funds (art 5 Act 19/92).

The first step

When an authorized credit company such as a bank or a building society makes a mortgage credit/loan to promote the land credit, it can refund it to carry on lending. It can then issue *participaciones hipotecarias*. These securities represent a part of a mortgage credit: a piece of the mortgage credit is attached to the security and when the investor — professional or not — buys it they acquire a percentage of the global capital of the mortgage credit. For example, the credit institution can retain 1% of the global capital of the loan and the investor can acquire 99%.

The reason for this is that Spanish legislation can accept neither a division of the loan's titularity nor its complete cession to an individual or to a professional (bank, building society, etc). The only institutions which can issue these securities are those regulated by article 2 LMH, the same ones that can make mortgage credits. Only institutions with mortgage credits (with the prerequisites that are in article 5 LMH: first mortgage

Division of property is impossible in the continental civil law system – the right of the owner must always be absolute

over the land, the loan cannot exceed 70% (80% in some cases) of the terrain's value, etc) can then issue *participaciones hipotecarias*. Note that this is different in English law — the originator makes the loans and the SPV issues the mortgage-backed securities.

The issue of *participaciones hipotecarias* does not represent debt to the issuer, unlike the issue of mortgage bonds; but it allows the mortgage credit funding.

With the quantities obtained by the sale, the credit company can carry on making loans. Since now, we have seen only the first step of the Spanish process of securitization. Although there has been an issue of securities, the *participaciones hipotecarias* are not like UK mortgage-backed securities — they only represent the transfer of mortgages, which in the UK the originator makes to the SPV — because in Spain there is also a movement of a percentage of the loans' value, from the institution which has the title of the mortgages to the institution or individual who acquires the security.

The second step

There is no problem in concluding a Spanish securitization with the issue of *participaciones hipotecarias* because both steps are independent, unlike in the UK. In the Anglo-American model it is necessary to complete every step to eventually produce some securities with which to refund the originator and the SPV.

In fact, the issue of *participaciones hipotecarias* has existed in Spain since 1981, whereas the second step, the creation of the mortgage securitization funds and the emission of *bonos de titulización hipotecaria*, has existed only since 1992 (Act 19/1992). In order to securitize there must exist a Fondo de Titulización Hipotecaria (mortgage securitization fund), which is composed of a pool of *participaciones hipotecarias* (not by a pool of mortgages). The fund, over this pool of *participaciones hipotecarias*, issues the *bonos de titulización hipotecaria* which are acquired by the investors.

Nevertheless the funds have no legal personality — because its members are not people, but *participaciones hipotecarias*. Also, this sort of institution is not well accepted in Spanish civil law, which can cause problems with the responsibility of the fund, its organization, its legitimation to issue securities and so on. Under common law this would not be a problem because it would be defined as a trust. The nearest example in Spanish law is the *fundaciones* (charitable trusts). Obviously, this kind of fund is not a charitable trust. In spite of the problems with the nature of the fund, what it is most important to know is that the *participaciones hipotecarias* cover the payment of the *bonos de titulización hipotecaria* and their owners are responsible for the payment of them. As with the American pass-throughs, the bondholders of the *bonos de titulización* have the co-titularity of the fund.

Special consideration to the bondholders' guarantee

In UK securitizations the trustee of the issue safeguards the rights of the bondholders and acts to protect them from

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insolvency or the effects of economic difficulty experienced by originators or SPVs. The trustee acquires an interest over the pool of mortgages to be securitized. It is an equitable interest known as a sub-mortgage; a mortgage of a mortgage. This is the guaranty of the UK mortgage-backed securities' bondholders: they are sub-mortgagees of the sub-mortgagor.

As in Spanish law the institution of the trustee is unknown, each bondholder of *participaciones hipotecarias*, called *partícipe*, and of *bonos de titulización hipotecaria*, called *bonista*, can exercise their own rights against the issuer and against other third parties.

On one hand, the *partícipe* has a double right — first, as creditor of the issuer of *participaciones hipotecarias* (his debtor), the *partícipe* can claim from him the payment of the security, but only if it is not due to a mortgagor — the person who has acquired the mortgage loan from the issuer — unpayment. If this is the case, he can constrain the issuer to execute the unrepaid mortgage; if the issuer doesn't want to do that, the *partícipe* can execute that mortgage himself directly against the mortgage debtor.

On the other hand, the *bonista* has the title of the *participaciones* rights because he is the owner of a piece of the pool of *participaciones hipotecarias*. He will have, then, the same rights but wouldn't be able to exercise them himself, but only through the manager of the fund — the people or societies that administer the fund.

While the protection of the UK mortgage-backed securities bondholders can be defined as a sub-mortgage, the Spanish bondholders have a personal action against the securities' issuer and in some circumstances the same rights as the mortgagee against the mortgagor.

Conclusion

The differences between the common and civil law systems — such as trusts and mortgages under common law — have not prevented the adoption of an Anglo-American style mortgage securitization process in Spain.

This introduction has brought some flexibility to Spanish civil law institutions such as the *hipoteca*, attaching a partial cession of mortgage credits to some securities, called *participaciones hipotecarias*.

As in the Anglo-American model, the Spanish process of securitization has two steps: the first one causes the exit of a percentage of mortgage credits from the total pool of mortgages that has the issuer by the issuing of *participaciones hipotecarias*; the second step consists on joining a pool of *participaciones hipotecarias* making a mortgage securitization fund and over them issuing other securities called *bonos de titulización hipotecaria*.

The *partícipe* and the *bonista* have almost the same rights against the issuer and against the mortgage debtor, but the *bonista* must exercise them through the manager of the fund.

Special thanks to the support of the Catalan government in the writing of this article.