

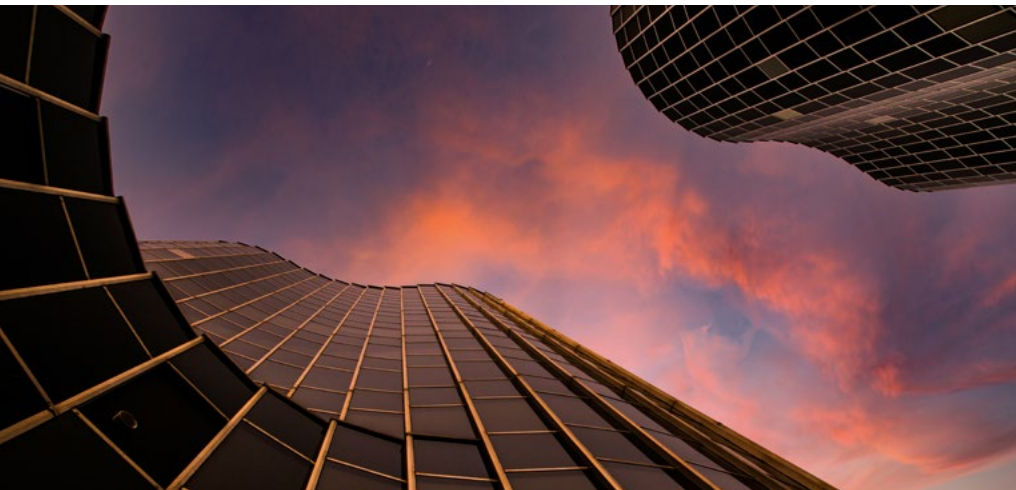


## Recent trends in Spanish Portfolio Acquisitions. Update on the legal regime of Spanish mortgage securities

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The Spanish market for secured non-performing loans (NPLs) is one of the largest and most active markets in Europe and Spain remains a preferred jurisdiction for international investors. Although for a number of years most portfolio disposals have been structured as a direct sale of secured NPLs, we are starting to see a number of transactions being launched in the Spanish market consisting of large portfolios of performing or reperforming mortgage loans which are sold to investors pursuant to Spanish securitisation techniques.

In fact, the market expectation is that the disposal of performing and re-performing secured loan portfolios will become increasingly common in Spain. The use of a Spanish securitisation fund (*fondo de titulización* or "FT") remains common and is a helpful tool particularly from a tax structuring perspective. However, some investors are seeing advantages in acquiring such portfolios using English law financing techniques, or with an eye to their subsequent cross-border securitisation under English law, through a special purpose issuer vehicle resident elsewhere in the EU. Regardless of the form of the acquiring vehicles, for mortgage loan portfolios in particular the nature of the instruments used to transfer the economic interest in the mortgage loans gives rise to a number of specific challenges and features, which we explain overleaf.



## Spanish Mortgage Securities

The disposal of Spanish performing and re-performing mortgage loan portfolios is being structured as a sale of mortgage participations (*participaciones hipotecarias*) ("PHs") and/or mortgage transfer certificates (*certificados de transmisión hipotecaria*) ("CTHs", and jointly with the PHs, the "Spanish Mortgage Securities") which are pass-through transferable securities traditionally used in Spanish securitisations and which have the effect of transferring to the participant the economic interest in the underlying mortgage loans. The main advantage of PHs and CTHs is tax-related since they entail a transfer of the economic rights of the underlying mortgage loans (including, without limitation, principal, interest and late payment interest) without triggering stamp duty tax or registration costs (which would otherwise be accrued in case of a direct transfer of Spanish mortgage loans and which represent a significant cost in Spanish transactions). The main downside of transferring a loan portfolio pursuant to PHs and CTHs is that the originator must continue to be the lender of record and consequently retains the right to foreclose and the relationship with the underlying borrowers. Although the holder of the PHs and CTHs is entitled to all collections and enforcement proceeds of the underlying loans, the fact that the seller remains in the structure can be a source of commercial tensions (for example risk of insolvency of the seller and account collection strategy, clashing servicing strategies of traditional Spanish sellers versus international special situation funds, etc.).

PHs and CTHs are securities of the same nature and subject to the same legal regime, differing mainly in the eligibility criteria of the underlying mortgage loans: while the mortgage loans underlying PHs must comply with certain requirements (in terms of LTV ratio, first-ranking mortgage, etc.), CTHs can be issued over mortgage loans of a lesser quality.

Spanish Mortgage Securities can only be issued by Spanish credit institutions and Spanish branches of credit institutions authorised in the EU (but limited to mortgage loans secured by real estate assets located in Spain). In case of insolvency of the entity issuing the Spanish Mortgage Securities, the holder of the Spanish Mortgage Securities would enjoy an absolute right of separation. Spanish Mortgage Securities are typically represented in physical form which creates a requirement to engage a third party custodian as well as the need to negotiate with the seller certain cooperation undertakings in order to ensure that the physical titles are kept up to date during the term of the subsequent securitisation.

As previously explained, the originator will continue to be the lender of record. Notwithstanding this, the originator is entitled to delegate to third parties a number of servicing duties regarding the underlying mortgage loans. In practice, this means that the investor is entitled to appoint a third-party servicer and control the servicing to a substantial degree (although the servicing in a PH/CTH structure used for the purposes of transferring mortgage loans to unrelated parties remains a commercial hurdle which often results in lengthy three-party negotiations).

The originator of the mortgage loans, as the issuer of the Spanish Mortgage Securities and lender of record, has the right to initiate foreclosure and ordinary proceedings (*derecho de legitimación activa*). However, the holder of the PHs and CTHs is vested by law with the following step-in rights in the event of default by the relevant borrower under the mortgage loan: (a) the right to compel the originator to commence enforcement of the relevant mortgage; (b) the right to join proceedings with the originator (with the same legal rights) for the enforcement by the originator against the relevant borrower and to appear to that effect in any enforcement proceedings brought by the originator; (c) should the originator fail to

commence enforcement proceedings within 60 calendar days from the notarial demand for payment addressed to the relevant borrower, the right to file a suit for the enforcement of the relevant mortgage; and (d) in the event that the proceedings brought by the originator against the relevant borrower are paralysed, the right to substitute itself for the originator as enforcing party and to resume the proceedings.

## Upcoming developments on the legal regime of PHs and CTHs following RDL 24/2021

On 2 November 2021, the Spanish government approved Royal Decree-Law 24/2021 ("RDL 24/2021"), which aims, among others, to transpose Directive (EU) 2019/2162 on the issue of covered bonds and covered bond public supervision. Although its main purpose is to regulate the regime for the issue and supervision of covered bonds issued by credit institutions, it also contains some regulation on PHs and CTHs.

It is worth noting that RDL 24/2021 mainly adopts the regulation for these instruments contained in the previous legal framework, without introducing major changes. Current regulatory provisions (namely Royal Decree 716/2009) will remain in force insofar as they do not contradict the provisions of RDL 24/2021 (also pending possible further legal development). To summarise the transitional regime of RDL 24/2021: (1) the relevant provisions referred to PHs and CTHs will enter into force on 8 July 2022 (i.e. they are not in force yet); (2) PHs and CTHs issued before 8 July 2022 will continue to be subject to the previous legal regime until their maturity; and (3) PHs and CTHs issued on or after 8 July 2022 will be subject to the regime of RDL 24/2021.

## The main developments of RDL 24/2021 in the legal regime of PHs and CTHs are:

- (A) For the purposes of article 20.8 of Regulation (EU) 2017/2402 (the "**Securitisation Regulation**"), which creates a prohibition on STS securitisation including transferable securities among their pool assets, RDL 24/2021 clarifies that the PHs and CTHs will only be deemed to be transferable securities (*valores negociables*) when, due to their own legal form and transfer regime, they may be capable of general and impersonal dealing in a financial market.
- (B) RDL 24/2021 also states that marketing, distribution and sale of PHs and CTHs between retail customers (i.e. not professional clients) is prohibited. Under the current regime, this limitation is only applicable to CTHs.

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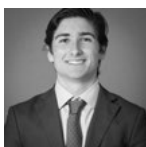
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