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ISSUING ASSET COVERED SECURITIES

A summary of the legislation and process

It should be noted that the Asset Covered Securities (Amendment) Act 2007 (Act/2007/013) (the "Amendment Act") is yet to be commenced, and that commencement is subject to new regulatory notices currently being prepared by the Financial Regulator. Furthermore, the provisions relating to commercial mortgages are not expected to be commenced with the remainder of the Act, as they are subject to further consideration. Set out below is a summary of the legislation as it will be after the Amendment Act is commenced.

1. INTRODUCTION

In response to the growing market for asset covered securities in Europe, Ireland introduced legislation in 2001 specifically to provide for the issue of Asset Covered Securities. The Asset Covered Securities (Amendment) Act, 2007 (the "Amendment Act") amends the Asset Covered Securities Act 2001¹. These amendments enhance Ireland's position in the highly competitive, innovative covered bond market. Asset Covered Securities are essentially securities backed by a defined pool of prescribed assets (normally mortgages). Asset Covered Securities differ from mortgage backed securities (MBS) in a number of ways, most notably that asset covered securities are issued directly by the originator or a subsidiary rather than through a special purpose vehicle, thereby retaining the mortgages on the originator's balance sheet.

¹ All references to provisions of the Act shall be construed as incorporating the amendments contained in the Amendment Act.

■ 2. THE ASSET COVERED SECURITIES ACTS 2001 AND 2007

2.1 Summary of the Legislation

The Act provides for the issuance of what the Act refers to as mortgage credit securities, public credit covered securities and/or commercial mortgage credit securities² (“**Asset Covered Securities**”) by certain Irish credit institutions which have been registered under the Act (the “**Institutions**”). The Institutions issue Asset Covered Securities which are secured by statutory preference under the Act on the mortgages, commercial mortgages or public credit assets (see paragraph 4.3 below) (“**Cover Assets**”) which are maintained within a defined pool of prescribed Cover Assets (the “**Pool**”). Unlike an issuing vehicle in an MBS transaction, the Institutions will be regulated by the Irish Financial Services Regulatory Authority (the “**Financial Regulator**”). Each institution is required to appoint a cover assets monitor (the “**Monitor**”) who is responsible for monitoring the Institutions compliance with certain sections of the Act (in particular, compliance of the Pool with the Pool requirements and any replacements and substitutions and maintenance of the Register). The Act also sets out criteria by which the Pool and Cover Assets can be managed.

■ 3. BECOMING A DESIGNATED INSTITUTION³

3.1 Designation of Institutions

Only Institutions designated under the Act may issue Asset Covered Securities. To register as an Institution (being a designated mortgage credit institution, designated commercial mortgage credit institution or a designated public credit

institution) the registrant must be a credit institution incorporated or formed in Ireland and not authorised by the Financial Regulator.

The Financial Regulator may designate an applicant as an Institution⁴ only if it is satisfied that the applicant:

- (i) is or will be able to carry out, in a proper manner, the responsibilities that an Institution is required by the Act to carry out;
- (ii) complies with, or will be able to comply with, such requirements (if any); and
- (iii) relating to Institutions as are prescribed by the regulations made and regulatory notices published by the Financial Regulator under the Act.

The Financial Regulator may impose conditions specific to the applicant with respect to the orderly and proper regulation of the applicant’s business which it considers appropriate and may, from time to time, vary or impose further conditions.⁵

3.2 Revocation of Designation as an Institution

At the request of the Institution, the Financial Regulator may revoke the institution’s registration under the Act, but only if it is of the opinion that the Institution has fully satisfied all claims and liabilities that are secured in respect of the Institution as provided by Part 7 of the Act.

The Financial Regulator may, with the consent of the Minister for Finance, revoke the registration of an Institution in certain other circumstances.⁶

In the case of an Institution whose registration has been revoked, but which is not being wound up, the Institution is required to continue to carry out the financial obligations of the Institution that

⁴ Section 14 of the Act

⁵ Section 14(3) of the Act

⁶ These circumstances include obtaining the registration by means of a false or misleading representation, non-compliance with the Act or a regulatory notice published by the Financial Regulator, certain insolvency processes, the Institution no longer having sufficient “own funds” (as referred to in the EU Codified Banking Directive), non-compliance of the Pool with relevant provisions of the Act or the Institution or any of its officers being convicted of certain criminal offences. A registration may also be revoked where the Institution has come under the control of any other entity that is not supervised by the Financial Regulator to such an extent that the Institution can no longer be supervised to the satisfaction of the Financial Regulator (Section 19(a-h)).

² The Amendment Act introduces provisions which permit the use of commercial mortgages as backing for covered bonds. Under the 2001 Act only residential mortgages and public sector debt were permitted to back covered bonds.

³ See Section 13 of the Act. (All references in this memorandum to section numbers correspond to sections in the Asset Covered Securities Act 2001 except where a section refers to a regulation and is stated as such.)

are secured under Part 7 of the Act until all those obligations have been fully discharged to the satisfaction of the Financial Regulator.⁷

3.3 Direction of the Financial Regulator Requiring an Institution to Suspend its Business

If the Financial Regulator reasonably believes that there may be grounds for revoking the registration of an Institution, it may, subject to Part 7 of the Act, prohibit the Institution from engaging in specific business activities which are referred to in Section 21(5) of the Act⁸ except with the permission of the Financial Regulator or if the approval of the Irish High Court has been obtained.

3.4 Multiple Designations

An Institution can be designated as a public credit institution, mortgage credit institution and/or commercial mortgage credit institution.⁹

4. COVER ASSETS POOL¹⁰

4.1 Generally

Institutions are required to maintain the Pool in accordance with the Act¹¹. The Monitor is required to approve the inclusion of any Cover Assets in the Pool.

In general, where an Institution becomes aware that it has contravened the requirements of the Act relating to the Pool that it is required to maintain, the Institution in question must take all possible steps to prevent the contravention from continuing or being repeated.

⁷ Section 21(2) as amended by section 14 of the Amendment Act

⁸ The Financial Regulator may prohibit the Institution from (a) dealing with the Institution's assets, (b) engaging in transactions and (c) making payments.

⁹ Section 13(5)

¹⁰ Chapter 1 Part 4 & Chapter 1A (as introduced by section 30 of the Amendment Act). These sections of the summary deal with the provisions of the Act relating to cover assets pools for mortgages, commercial mortgages and public credits. Where a footnote refers to two sections of the Act, the first reference is to the section relating to mortgages and the second reference is to the corresponding section relating to public credit assets.

¹¹ Section 32(1), section 41B and Section 49

An Institution shall, as soon as is practical after becoming aware that a Cover Asset comprised in its Pool would, if the Institution were to include that asset at that time in its Pool, contravene the credit worthiness standards (as specified by the Financial Regulator¹²), remove that Cover Asset from the Pool and replace it if required to do so by the Act¹³.

Until those steps have been taken, the Institution may not issue further Asset Covered Securities¹⁴. If at any time after the Monitor has become aware, or has formed a reasonable suspicion, that the Institution has contravened or failed to comply with a provision of the Act that relates to the responsibilities of a Monitor, it is required to provide the Financial Regulator with a written report of the matter. (See Part 12 "The Cover-Assets Monitor".)

4.2 Status of Cover Assets¹⁵

Cover Assets that are comprised in the Pool are excluded from forming part of the assets of an Institution, its parent or a related company, for the purposes of any insolvency process and until the claims secured by Part 7 of the Act are fully discharged.

4.3 Categories of Assets that may be included in the Pool

A Pool maintained by an Institution may include only mortgage credit assets, commercial mortgage credit assets, public credit assets, substitution assets, cover assets and hedge contracts as described below.

(a) Mortgage Credit Assets

A "mortgage credit asset" is defined as:

- (i) an asset or property -
 - (A) held or to be held by a designated or formerly designated mortgage credit institution, and

¹² Section 35(8)(a), 48(2), and 50(8)(a) as introduced by the Amendment Act

¹³ Section 34(2A) & 49(2A) as inserted by the Amendment Act

¹⁴ Section 34(1), section 41B and Section 49

¹⁵ Section 85(2) and (3)

- (B) that comprises one or more mortgage credits; or
- (ii) an asset or property -
 - (A) held or to be held by a designated or formerly designated commercial mortgage credit institution, and
 - (B) that comprises one or more commercial mortgage credits,

but does not include an asset or property which comprises all or any part of any pool hedge collateral property¹⁶.

A “mortgage credit” is any kind of financial obligation in respect of money borrowed or raised that is secured by a mortgage, charge or other security on residential property or commercial property, but only if the property is located in the State or any other EEA country, a category A country or a category B country. Mortgage credit also includes any kind of credit for the time being designated by the Minister of Finance.¹⁷ The definition of financial obligation includes a financial obligation that is in the form of security that represents an interest in other mortgage credit that is securitised.¹⁸

It should be noted that the Amendment Act incorporated into the Act the definition of “securitisation” from the Codified Banking Directive in respect of mortgage credit assets and commercial mortgage credit assets. This definition does not extend to public credit assets.

Inclusion of financial obligations which are themselves securitised financial obligations will greatly increase the range of mortgage credits which can form part of a Pool. For example an Institution should now be able to purchase RMBS from other jurisdictions (Please see 7.3 below for further details on securitised mortgage credits).

(b) Public Credit Assets

A “public credit asset” is defined as an asset or property held by an Institution that comprises one or more public credits, but it does not include an asset or property that comprises all or any part of any pool hedge collateral.¹⁹

The Act²⁰ defines “public credit” as any kind of financial obligation in respect of money borrowed or raised, where the person who has the obligation is any one of the following:

- (i) central governments, central banks, public sector entities, regional governments or local authorities in the State or in any other EEA country;
- (ii) central governments, central banks, public sector entities, regional governments or local authorities in the State or in any other EEA country;
- (iii) central governments and central banks in Australia, Canada, Japan, New Zealand, the Swiss Confederation, the United States of America or a country specified in an order made under subsection (3);
- (iv) public sector entities, regional governments and local authorities in Australia, Canada, Japan, New Zealand, the Swiss Confederation, the United States of America or a country specified in an order made under subsection (3);
- (v) (i) multilateral development banks which qualify as such for the purposes of the Codified Banking Directive²¹,

¹⁶ Section 3, as amended by section 2 of the Amendment Act

¹⁷ Section 4(1)

¹⁸ Section 4(4), as inserted by section 3 of the Amendment Act

¹⁹ Section 3, as amended by section 2 of the Amendment Act

²⁰ Section 4(1), as amended by section 3 of the Amendment Act

²¹ Directive 2006/48/EC

- (ii) international organisations which qualify as such for the purposes of the Codified Banking Directive,
- (vi) central governments, central banks, public sector entities, regional governments or local authorities in a Category B country; or
- (vii) any other entity established in a country to which paragraph (i), (ii) or (vi) relates that is prescribed by order of the Minister for the purpose of this section.²²

The definition of financial obligation includes a financial obligation that is in the form of security that represents an interest in other mortgage credit that is securitised²³, as well as one that does not.

Inclusion of financial obligations which are themselves securitised financial obligations will greatly increase the range of public credits which can be included in a Pool.

(c) Commercial Mortgage Credit Assets

A commercial mortgage credit asset²⁴ means property or an asset:

- (i) held or to be held by a designated or formerly designated commercial mortgage credit institution; and
- (ii) which comprises one or more commercial mortgage credits;

but does not include property or an asset which comprises all or any part of any pool hedge collateral.

“Commercial mortgage credit”²⁵ means mortgage credit which is secured on commercial property.

(d) Substitution Assets

The Act²⁶ defines substitution assets as:

- (i) deposits with an eligible financial institution²⁷ (see below);
- (ii) Tier 1 assets for the purposes of the European System of Central Banks’ monetary policy operations; and
- (iii) any asset designated a substitution asset in an order made by the Minister for Finance.

(e) Securitised Assets

The Act defines “securitised mortgage credit asset” as an asset which qualifies as a mortgage credit asset by virtue of section 4(4) of the Act.

It should be noted that this definition does not extend to public credit assets.

Section 4(8) states that “securitised” shall be construed in accordance with Article 4(36) of the Codified Banking Directive.

4.4 Location

Under the Act, a mortgage credit is located in the country in which the property asset securing the mortgage credit is located. A public credit asset is located in the country in which the entity that has the primary financial obligation in respect of the asset is formed or established. The country in which a substituted asset is located is the country where the entity with the primary financial obligation in respect of the asset is formed or established. A substitution asset which is a deposit is situated in the country in which the place of business of the financial institution that is holding the deposit is located.²⁸

The cover assets and substitution assets comprised in the Pool may be located within any European Economic Area (“EEA”) country or be financial obligations of the European

²² Section 5(1), as amended by section 4 of the Amendment Act

²³ Section 4(4), as inserted by section 3 of the Amendment Act

²⁴ Section 3, as inserted by section 2 of the Amendment Act

²⁵ Section 3, as inserted by section 2 of the Amendment Act

²⁶ Section 6(1)

²⁷ For the purposes of (a) above, the Financial Regulator’s regulations provide that the following financial institutions are eligible financial institutions:

(a) (i) Any credit institution which is authorised in Ireland or any other EEA country, or
(ii) A bank which is authorised to receive deposits or other repayable funds from the public and is located in Canada, Japan, the Swiss Confederation, the United States of America, and

(b) which is rated by Moody’s Investor Services at A1 or higher in respect of its long term debt, or P-1 in respect of its short term debt or the equivalent rating by another rating agency.

²⁸ Section 3(2)

Communities (or any of them) or the European Investment Bank.

An Institution may include in the Pool a mortgage credit asset or substitution asset that is located within one or more category A countries and may not include in the cover assets pool a mortgage credit asset or substitution asset that is located within one or more category B countries.²⁹

A “**category A country**” is defined in the Act as Australia, Canada, Japan, New Zealand, the Swiss Confederation, the United States of America, or a country specified in an order made by the Minister for Finance³⁰.

A “**category B country**” is defined in the Act as a country, other than a EEA country or a Category A country, that is a full member of the Organisation for Economic Co-operation and Development, but only if it has not rescheduled its external debt during the immediately preceding five years.³¹

The Act³² specifies limitations on the level of Cover Assets or substitution assets held by an Institution in the course of its general business activities which may be located in category B countries.

■ 5. RESTRICTIONS ON ASSETS INCLUDED IN THE POOL

5.1 Restrictions on Replacement of Underlying Assets Included in the Pool

A Cover Asset or substitution asset may replace an underlying asset (defined in relation to a Pool as a public credit asset, mortgage credit asset, commercial mortgage credit asset or substitution asset that is then included in the Pool) only if the replacement has been approved by the Monitor.³³

An Institution is required to replace an underlying asset with a Cover Asset or substitution asset if the underlying asset contravenes or fails to comply

with a provision of the Act, the regulations made by the Financial Regulator under the Act or a requirement of the Financial Regulator or the Monitor made under the Act.³⁴

In general, an Institution may not replace an underlying asset with a Cover Asset or a substitution asset if the asset would not have been eligible for initial inclusion in the Pool.

5.2 Restrictions on Inclusion of Substitution Assets in the Pool³⁵

The total prudent market value of all substitution assets included in a Pool may not exceed 15% of the total prudent market value of all of the aggregate nominal or principal amount of outstanding Cover Assets in the Pool, or such other percentage as the Minister for Finance may prescribe. The Financial Regulator may, however, suspend the above ratio requirement if it is satisfied that to do so would facilitate the discharge of secured claims.

An Institution may not at any time include a substitution asset in a Pool unless the substitution asset meets the credit worthiness standards or criteria applicable to it which may be specified by the Financial Regulator in a regulatory notice made for the purpose of this restriction.

The Financial Regulator has prescribed by regulation the following kinds of substitution assets that may be included in a Pool:

- (a) Tier 1 assets having a maximum term to maturity of three months from the date upon which they are approved by the Monitor for inclusion in the Pool and entered into the register of public credit covered securities business; and
- (b) deposits with eligible financial institutions, in each case having a maximum term of deposit of three months from the date upon which they are approved by the Monitor for inclusion in the Pool and entered into the register of public credit covered securities business.

²⁹ Section 32(2). The reference to “mortgage credit assets” shall be taken to include commercial mortgage credit assets.

³⁰ Section 5(1)(a)

³¹ Section 5(1)(a) as amended by section 4 of the Amendment Act

³² Section 31(1) and Section 46(1)

³³ Section 35(2) and Section 50(2)

³⁴ Section 35(3) and Section 50(3)

³⁵ Section 35(8) and Section 50(8), as amended by section 23 of the Amendment Act

5.3 Other Restrictions

Non-performing assets may not be included in a Pool³⁶.

The amount of mortgage credit assets, which are backed by commercial property, is limited to 10% of the relevant Pool. There are also restrictions on the inclusion in the relevant Pool of mortgage credits backed by assets in the process of development.³⁷

6. RELEASING ASSETS FROM THE POOL

6.1 Use of Realised Proceeds of Cover Assets

Money received by an Institution as the proceeds of realising a Cover Asset forms part of the Pool, until it is used to create or acquire permitted mortgage credit, commercial mortgage credit, public credit assets or substitution assets for inclusion in the Pool, to discharge secured claims under the Act (see 11.1 “Insolvency of Institutions”), is released from the Pool as an underlying asset and is replaced by other public credit assets or substitution assets, or is released from the Pool in accordance with the Act.

6.2 Release of Underlying Assets from the Pool³⁸

An Institution may, with the prior consent of the Monitor, release underlying assets from the Pool if the assets are not required to be comprised in the Pool to secure secured claims.

³⁶ “Non-performing” is defined in the context of an Institution to mean that the relevant asset is in the course of being foreclosed or otherwise enforced or that one or more payments of principal or interest payable on the related credit are in arrears for ten days or more under the terms of the security documents that govern that credit.

³⁷ Section 33(5) and (6)

³⁸ Section 36(4) and Section 51(4)

7. PERMITTED ACTIVITIES AND RESTRICTIONS ON ACTIVITIES OF AN INSTITUTION

7.1 Restrictions on the Activities of an Institution

An Institution may not carry on a business activity other than a permitted business activity (see 7.2)³⁹. However entities which hold dual-designation or multi-designation (relating to two or more of public credit, commercial mortgage credit and mortgage credit activities) may carry out the permitted activities in respect of each of those designations. This does not prevent an institution that is also registered as a different kind of designated credit institution permitted by the act from carrying on business activities that can be lawfully carried on by such designated credit institutions.

7.2 Permitted Business Activities in which an Institution may Engage⁴⁰

The permitted business activities in which an Institution may engage (subject to the restrictions described in 7.3) are:

- (a) providing mortgage credit, commercial mortgage credit or public credit (as the case may be) and dealing in and holding mortgage credit, commercial mortgage credit and public credit assets and providing group mortgage trust services (as the case may be);
- (b) dealing in and holding substitution assets;
- (c) dealing in and holding assets of a kind that, in accordance with the requirements of the Financial Regulator made under the supervisory enactments, designated credit institutions are required to hold for regulatory purposes;

³⁹ Section 28 and Section 43

⁴⁰ Section 27(1) and Section 42(1)

- (d) dealing in and holding credit transaction assets⁴¹;
- (e) dealing in and holding Tier 2 assets;
- (f) engaging in activities connected with financing or refinancing assets or activities permitted by the relevant section⁴²;
- (g) entering into certain hedging contracts; and
- (h) engaging in activities that are incidental or ancillary to the foregoing activities.

7.3 General Restrictions on types of Cover Assets

An Institution is required to ensure that the total value of the credit transaction assets and Tier 2 assets that it holds, expressed as a percentage of the total value of all of the Institution's assets, does not at any time exceed 10% (or such other percentage as may be specified by an order of the Minister for Finance (although, as at the date hereof, no relevant order has been made) of the total value of all of the Institution's assets.⁴³

The Financial Regulator, by giving notice in writing to an Institution, may impose on an Institution or on any class of Institutions, requirements or restrictions as to the kinds of credit transaction assets or Tier 2 assets that the Institution or class of Institutions may hold.⁴⁴

⁴¹ Section 27(3) and Section 42(3) defines a "credit transaction asset" as an asset derived from having engaged in a credit transaction (not being a hedge contract entered into in accordance with section 30) but does not include any asset arising from the activities referred to at (c) and (f), credit assets, substitution assets or tier 2 assets. A "credit transaction" is defined as:

- (a) placing a deposit with a financial institution which has been designated as eligible for such purposes by order made by the Financial Regulator (see below);
- (b) dealing with or holding a financial asset; or
- (c) any other kind of transaction designated as such by the Minister for Finance by order. At the date hereof no relevant order has been made.

A "financial asset" is defined to include shares, gilts, bonds, derivatives and debt portfolios.

Regarding paragraph (a) above, the Financial Regulator has designated by order the following financial institutions as eligible financial institutions:

- (a) (i) any credit institution which is authorised in Ireland or any other EEA country, or
- (ii) a bank which is authorised to receive deposits or other repayable funds from the public and is located in Canada, Japan, the Swiss Confederation, the United States of America, and
- (b) which is rated by Moody's Investor Service at A1 or higher in respect of its long term debt, or P-1 in respect of its short term debt an equivalent rating by another rating agency.

⁴² Section 27(1)

⁴³ Section 31(2) and Section 46(2)

⁴⁴ Section 31(4) and Section 46(4)

Securitised mortgage credits may only be included by a designated mortgage credit institution in the Pool if those assets satisfy the following requirements:

- (a) securitised mortgage credit assets is established under and subject to the laws of an EEA country; and
- (b) at least 90% of the assets held, directly or indirectly, by the securitisation entity are assets that comprise one or more mortgage credits, but disregarding:
 - (i) assets that comprise one or more mortgage credits which if they were held by a designated mortgage credit institution would only qualify as mortgage credit assets under section 4(4), and
 - (ii) such assets representing exposures caused by transmission and management of payments of the obligors under, or liquidation proceeds in respect of, assets that comprise one or more mortgage credits;
- (c) the securitised mortgage credit assets constitute senior claims of the securitisation entity in that they meet any creditworthiness standards or criteria which may be specified by the Financial Regulator in a regulatory notice made for the purposes of this paragraph;
- (d) the nominal or principal amount outstanding of the securitised mortgage credit assets comprised in the cover assets pool at any time do not exceed any applicable percentage, which may be specified by the Financial Regulator by regulatory notice, of the nominal or principal amount of the outstanding mortgage covered securities issued by the institution⁴⁵; and
- (e) the securitised mortgage assets have a prudent market value not greater than the amount determined under section 41A(2) in respect of those assets.

⁴⁵ No such regulatory notice has yet been issued.

■ 8. FINANCIAL CRITERIA

8.1 Financial Matching Criteria for the Pool and Asset Covered Securities

The Act⁴⁶ sets out certain financial matching requirements which must be met by an Institution in respect of its Pool and Asset Covered Securities. These criteria are that:

- (a) the Pool maintained by an Institution has a duration⁴⁷ (see below) of not less than the Asset Covered Securities that relate to the Pool;
- (b) the prudent market value of the Pool is greater than the total of the principal amount of those Asset Covered Securities that relate to the pool;
- (c) the total amount of interest payable in a given period of 12 months in respect of the Pool is during that 12 month period not less than the total amount of interest payable in respect of that period on those Asset Covered Securities; and
- (d) the currency in which each public credit asset, mortgage credit asset or substitution asset comprised in the Pool is denominated is the same as the currency in which those Asset Covered Securities are denominated,

after taking into account, in the case of paragraphs (a), (b) and (c) above, the effect of any cover assets hedge contract (see paragraph 10 below) that the Institution has entered into in relation to the Pool and those Asset Covered Securities- but disregarding the effect of any pool hedged collateral.

⁴⁶ Section 47(8)

⁴⁷ "Duration" means, in relation to cover assets pool, public asset covered securities, mortgage covered securities and commercial mortgage covered securities a weighted average term to maturity of the relevant principal amount of the mortgage credit assets and substitution assets comprised in the Pool or those securities, as the case may be, determined in accordance with a formula or criteria specified in a regulatory notice made for the purpose of the subsection and taking into account the effect of any relevant cover asset hedge contract entered into by the institution in relation the pool or those securities, or both, as the case may be. In relation to public credit assets the weighted average term to maturity of the principal of the principal or nominal amount of the public credit assets and substitution assets comprised in the cover Pool must not be more than 3 years greater than the weighted average term to maturity of the public credit covered securities secured on that Pool after taking into account the effect of any relevant cover assets hedge contract entered into by the institution in relation to the pool or those securities, or both, as the case may be (section 47(9A)).

8.2 Valuation of Assets held by an Institution

The prudent market value of a public credit asset comprised in the Pool maintained by an Institution is an amount denominated in the currency in which the related public credit is denominated, equal to 100% (or such other percentage as may be specified by regulations made by the Financial Regulator (although, as of the date of this Memorandum, no relevant regulations have been made)) of the principal or nominal amount of that public credit that is outstanding on the date concerned.

The Financial Regulator may specify, by regulatory notice, further requirements in relation to the valuation basis and methodology, time of valuation and any other matter that it considers relevant for determining the prudent market value of public credit assets for the purposes of the Act. The Act also empowers the Financial Regulator to specify, by regulatory notice, requirements in relation to the valuation basis and methodology, time of valuation and any other matter that it considers relevant for determining the prudent market value of substitution assets, Tier 2 assets, credit transaction assets, or the total assets held by an Institution for the purposes of the Act.⁴⁸

The Authorities may, by regulatory notice, specify requirements for valuing mortgage credit assets.

8.3 Overcollateralisation

Institutions are required to maintain a minimum level of regulatory overcollateralisation of its cover assets pool with respect to the mortgage covered securities in issue which are secured on the pool. Regulatory overcollateralisation means the prudent market value of the mortgage credit assets, public credit assets and substitution assets comprised in the cover assets pool, expressed as a percentage of the total of the nominal or principal amounts of the mortgage covered securities in issue which are secured on that pool, is a minimum of 103% after taking into account the effect of any cover assets hedge contract

⁴⁸ The Financial Regulator published the Asset Covered Securities Act, 2001 Regulatory Notice (Section 56(3) and Section 56(5)) on 13th August 2002. In the Notice, the Financial Regulator specified requirements in relation to the valuation basis and methodology and time of valuation of substitution assets, Tier 2 assets, credit transaction assets and total assets.

comprised in the covered asset pool⁴⁹. The mandatory overcollateralisation in relation to commercial mortgage covered securities shall be 110%⁵⁰.

8.4 Security Interests

The Act⁵¹ provides that an Institution (or a formerly designated credit institution) may not create a security interest⁵² in respect of any Cover Assets comprised in the Pool if Asset Covered Securities are outstanding or if a cover assets hedge contract is in existence and if such security interest would, but for Part 7 of the Act, adversely affect the priority conferred by Part 7 of the Act on preferred creditors. If an Institution creates any such security interest, the interest is void and any money secured by it is repayable immediately. If a Cover Asset included in a Pool is subject to a security interest which would contravene this requirement, the relevant Institution is required to replace such Cover Asset.

To the extent that the claims of all preferred creditors are not fully satisfied from the proceeds of the disposal of the Cover Assets comprised in the Pool maintained by the relevant Institution, such creditors become unsecured creditors with respect to the unsatisfied part of their claims in the insolvency process relating to the Institution, the claims of the super-preferred creditors ranking above those of the other preferred creditors in this regard.⁵³

8.5 Financial Statements

Under the Act, any parent of a mortgage credit institution is required to include certain designated information in its financial statements. Designated public credit institutions are required to include certain specific information in their own financial statements.

⁴⁹ Section 32(17) as amended by section 20 of the Amendment Act and Section 47(14) as amended by section 35(d) of the Amendment Act

⁵⁰ Section 41B as amended by section 30 of the Amendment Act. Previously overcollateralisation was determined on a case by case basis.

⁵¹ Section 88

⁵² As defined in section 88(4) a "security interest" includes mortgage, charge, pledge, lien and encumbrance.

⁵³ Section 83(5)

9. REGISTER OF CREDIT COVERED SECURITIES BUSINESS⁵⁴

An Institution is required to establish and keep a register⁵⁵ in respect of:

- (a) the Asset Covered Securities it has issued;
- (b) the cover assets hedge contracts (see below) that it has entered into; and
- (c) the Cover Assets and substitution assets that it holds as security for those Asset Covered Securities and contracts.

An Institution is required at all times to provide access to the Register to the Financial Regulator and the Monitor appointed in respect of such Institution, and to permit each such person to take copies of the Register or any entry in the Register at such Institution's expense.⁵⁶

If a designated credit institution is also registered as a different kind of designated credit institution, the institution is required, for example, to keep its register of commercial mortgage covered securities business separate from its register of mortgage covered securities business or its register of public credit covered securities business as applicable.⁵⁷

10. COVER ASSETS HEDGE CONTRACTS

An Institution is permitted under the Act to enter into certain hedging contracts related to its permitted activities including the maintenance of its Pool and the issuance of Asset Covered Securities.⁵⁸ Those contracts that relate only to certain Cover Assets and Asset Covered Securities and are comprised in the Pool are called "cover assets hedge contracts".

⁵⁴ Section 38, 41B and 53

⁵⁵ A separate register should be kept for mortgage credit assets, commercial mortgage credit assets and public credit assets of Cover Assets.

⁵⁶ Section 39(1) and Section 51(1)

⁵⁷ Section 41B, as inserted by section 30 of the Amendment Act

⁵⁸ Section 30 and Section 45

A cover assets hedge contract must state, among other things, that it is a cover assets hedge contract entered into in accordance with the Act, and a cover assets hedge contract must comply with the requirements (if any) specified in any relevant regulatory notice published by the Financial Regulator. As of the date hereof the Financial Regulator has not published a regulatory notice specifying any such requirements.

An Institution must establish and keep a register in respect of any pool hedge collateral that it holds from time to time. This register must be kept separate from the register of mortgage credit assets, commercial mortgage credit assets and public credit assets.

The Institutions must include in the register of pool hedge collateral the following particulars:

- (a) particulars of the pool hedge collateral it holds from each counterparty to a cover assets hedge contract;
- (b) particulars of the cover assets hedge contracts that relate to the pool hedge collateral;
- (c) where the institution is registered as more than one kind of designated credit institution, particulars of the relevant cover assets pool to which the pool hedge collateral relates; and
- (d) such other particulars as are prescribed by regulatory notice.

■ 11. INSOLVENCY

11.1 *Insolvency of Institutions*

Part 7 of the Act over-rides a number of the usual provisions of law that address insolvency of Irish companies and banks.

11.2 *Dissolution of an Institution*⁵⁹

An Institution may not be dissolved under an insolvency process until the claims and rights of all preferred creditors have been fully satisfied. However, if the Court is satisfied that the

Institution has no assets capable of meeting the claims and rights of those creditors, it may make an order dissolving the Institution.

11.3 *Effect of Insolvency or Potential Insolvency on Certain Obligations*⁶⁰

The fact that an Institution or its parent entity or any company related to the Institution has become insolvent or potentially insolvent does not affect:

- (a) the claims and rights of holders of Asset Covered Securities issued by the Institution;
- (b) the claims and rights of a person (other than the holder of an Asset Covered Security issued by the Institution) who has rights under or in respect of any such Asset Covered Security by virtue of any legal relationship with the holder;
- (c) the claims and rights that the other contracting party has under any cover assets hedge contract entered into by the Institution;
- (d) the appointment of a Monitor and the relevant claims and rights of such Monitor in so far as those claims and rights relate to the appointment or arise under the Act;
- (e) the appointment of a manager in respect of the Institution and the relevant claims and rights of such manager in so far as those claims and rights relate to the appointment or arise under the Act. (See paragraph 12.2); and
- (f) the functions of the National Treasury Management Agency under Part 6 of the Act and the relevant claims and rights of the National Treasury Management Agency in so far as those claims and rights relate to those functions.

11.4 *Treatment of Overcollateralisation Undertakings*

Where an Institution enters into a contractual undertaking with the Monitor appointed to it that it will maintain specified levels of overcollateralisation, then:

⁵⁹ Section 86

⁶⁰ Section 82(a-f)

- (a) prior to the occurrence of an insolvency process with respect to the Institution, the Monitor cannot agree to the removal from the Pool of Cover Assets or substitution assets that represent overcollateralisation if that removal would result in specified overcollateralisation levels being breached; and
- (b) on the occurrence of an insolvency process with respect to the Institution, the Monitor cannot agree to the removal from the Pool of Cover Assets or substitution assets that represent overcollateralisation (so as to make them available to creditors of the Institution other than preferred creditors) prior to all claims of preferred creditors secured by Part 7 of the Act being satisfied in full (see paragraph 11.1 “Insolvency of Institutions”) if that removal would result in the specified overcollateralisation levels being breached.

11.5 Preferred and Super-Preferred Creditors⁶¹

Where an Institution (or formerly designated credit institution), or its parent entity or any company related to the Institution becomes subject to an insolvency process, preferred creditors are, for the purpose of satisfying their claims and rights under Part 7 of the Act, entitled to have recourse to the Cover Assets that are comprised in the Pool maintained by the Institution ahead of members of, and contributors to, the Institution and all other creditors of the Institution, its parent entity or company related to the Institution. This provision applies irrespective of whether the claims of creditors other than preferred creditors are preferred under any other enactment or any rule of law and whether those claims are secured or unsecured.

“Preferred creditors” are defined in the Act⁶² as all or any of the following persons:

- (a) the holder of outstanding Asset Covered Securities issued by the Institution;
- (b) a person (other than the holder) who has rights under or in respect of any such Asset

Covered Security by virtue of any legal relationship with the holder;

- (c) a person with whom the Institution has entered into a cover assets hedge contract, but only if the person is in compliance with the financial obligations imposed under the contract; and
- (d) a person who is a super-preferred creditor in relation to the Institution.

The claims of a super-preferred creditors rank ahead of those of the other preferred creditors⁶³. “Super-preferred creditors” are defined in respect of an Institution as a Monitor or manager appointed in respect of that Institution.

12. THE COVER ASSETS MONITOR

12.1 Appointment of a Cover Assets Monitor⁶⁴

The Act requires every Institution to appoint a qualified person to be a cover-assets monitor (a “Monitor”) in respect of the Institution. An appointment of a Monitor by an Institution does not take effect until it is approved in writing by the Financial Regulator.

12.2 Qualifications of a Monitor

The Financial Regulator has specified in a regulatory notice⁶⁵ the qualifications for an appointment as a Monitor in respect of an Institution. These include:

- (a) a Monitor must be a body corporate or partnership, comprising personnel and partners respectively who are members of a professional representative body. The Monitor must demonstrate to the satisfaction of the Financial Regulator that it is experienced and competent in the following areas:
 - (i) financial risk management techniques;

⁶¹ Section 83(1)

⁶² Section 3

⁶³ Section 83(3)

⁶⁴ Section 59

⁶⁵ Amended Regulatory Notice Section 59(6)

- (ii) regulatory compliance reporting; and
 - (iii) capital markets, derivatives, public credit business and mortgage credit business as applicable;
- (b) a Monitor must demonstrate that it has sufficient resources at its disposal, and its personnel or partners must have sufficient academic or professional qualifications and experience in the financial services industry to satisfy firstly the designated credit institution and secondly the Financial Regulator, that it is capable of fulfilling this role; and
- (c) a Monitor must not be an affiliate of the Institution or of any affiliate of the Institution.

12.3 Duties of the Monitor before an Institution issues Asset Covered Securities⁶⁶

Before an Institution issues Asset Covered Securities or enters into a cover assets hedge contract, the Monitor must take reasonable steps to verify:

- (a) that the Institution will be in compliance with the financial matching requirements of the Act with respect to the Pool and Asset Covered Securities and will not be in contravention of the requirements in respect of location of Cover Assets or of the restrictions on the inclusion of substitution assets in the Pool as a result of issuing the Asset Covered Securities or entering into the hedge contract;
- (b) that the Institution will comply with the requirements of the Act with respect to keeping its Register; and
- (c) such other matters relating to the business of Institutions as may be prescribed by regulations made by the Financial Regulator.

12.4 Continuing Duties of the Monitor

The Monitor is responsible for monitoring the Institution's compliance with the provisions of

the Act relating to financial matching criteria for the Pool and Asset Covered Securities, replacement of Cover Assets in the Pool, inclusion of substitution assets in the Pool, maintenance of the Institution's Register and such other matters as may be prescribed by regulations made by the Financial Regulator.

Under regulations⁶⁷ adopted by the Financial Regulator, the Monitor is also responsible for monitoring the Institution's compliance with regulations regarding sensitivity to interest rate changes and with any contractual undertakings given by the Institution to maintain a level of overcollateralisation⁶⁸ of Cover Assets as against Asset Covered Securities.

12.5 Duty of the Monitor to Inform the Financial Regulator of Certain Matters⁶⁹

As soon as practicable after the Monitor has become aware, or has formed a reasonable suspicion, that the Institution in respect of which it has been appointed has contravened or failed to comply with a provision of the Act (which includes regulations made by the Financial Regulator under the Act) that relates to the responsibilities of the Monitor, the Monitor is required to provide the Financial Regulator with a written report of the matter. The Monitor is also required to provide the Financial Regulator with reports and information as requested from time to time by the Financial Regulator regarding the Institution's compliance or non-compliance with the provisions of the Act that relate to the responsibilities of the Monitor.

12.6 Power of the Monitor to Enter an Institution's Business Premises/Obtain Information from an Institution⁷⁰

A Monitor may, upon giving the Institution in respect of which it has been appointed reasonable notice, enter at any reasonable time during ordinary business hours any place at which the Institution carries on its business for the purpose

⁶⁷ Sensitivity to Interest Rate Changes, Regulations 2003

⁶⁸ Overcollateralisation Regulations 2002

⁶⁹ Section 67(1)

⁷⁰ Section 65(1)

⁶⁶ Section 62 as amended by section 46 of the Amendment Act

of carrying out the Monitor's responsibilities in relation to the Institution.

A Monitor may also, by notice in writing to the relevant Institution, require it to give to the Monitor, within such period as may be specified in the notice, any specified information or record that relates to the responsibilities of the Monitor in respect of the Institution, but only if the information or record is in the possession, or under the control, of the Institution.

12.7 Duties of an Institution to Inform its Monitor of Certain Matters⁷¹

An Institution is required to keep its Monitor informed of certain information relating to the Pool and the Cover Assets.

12.8 Priority of a Monitor on an Insolvency of the Institution⁷²

The Monitor of an Institution, along with any manager that has been appointed to the Institution, constitute "super-preferred" creditors of the Institution. The claims of super-preferred creditors rank ahead of those of any other preferred creditors (including holders of Asset Covered Securities). See 11.1 "Insolvency of Institutions".

12.9 Termination of Appointment of a Monitor by an Institution⁷³

An Institution may terminate the appointment of its Monitor only with the written consent of the Financial Regulator. The Financial Regulator may direct an Institution to terminate the appointment of its Monitor and to appoint another qualified person in place of that Monitor.

12.10 Resignation of a Monitor⁷⁴

A Monitor may resign by giving at least 30 days notice in writing to the Financial Regulator (unless the Financial Regulator agrees to a shorter

notice period) and must include in such notice a statement of the reasons for its resignation.

12.11 Limitation on the Civil Liability of a Monitor

The Monitor, officers and employees of the Monitor, and persons acting under the direction of the Monitor are not liable in any civil proceedings for any act done, or omitted to be done, by the person for the purposes of, or in connection with, performing or exercising any function or power imposed or conferred on the Monitor by or under the Act if the act was done, or was omitted, in good faith for the purposes of the Act.

13. SUPERVISION

The Financial Regulator is primarily responsible for the supervision and regulation of Institutions such as the Issuer.

13.1 General Functions of the Financial Regulator

The Act⁷⁵ provides that the functions of the Financial Regulator are as follows:

- (a) to designate credit institutions for the purposes of the Act;
- (b) to administer the system of supervision and regulation of designated credit institutions in accordance with the Act in order to promote the maintenance of the proper and orderly regulation and supervision of those institutions; and
- (c) to perform such other functions as are prescribed by or under the Act.

In addition, the Financial Regulator is given a general power to do all things necessary or expedient to be done for or in connection with, or incidental to, the performance of its functions.⁷⁶

⁷¹ Section 67(2)

⁷² Section 83

⁷³ Section 63(1) and 63(2)

⁷⁴ Section 9(1)

⁷⁵ Section 9(1)

⁷⁶ Section 10(1)

13.2 Power of the Financial Regulator to Appoint the NTMA or a Recommended Person as Manager of an Institution⁷⁷

The Financial Regulator may appoint the National Treasury Management Agency (the “NTMA”) or a person recommended by the NTMA as manager of an Institution in the event of the insolvency or potential insolvency of an Institution or to safeguard the interests of holders of Asset Covered Securities, persons who have rights under cover asset hedge contracts or other creditors of the Institution.

⁷⁷ Section 72(1)

13.3 Limitation on the Civil Liability of the Financial Regulator⁷⁸

The Financial Regulator, members and employees of the Financial Regulator, and persons acting under the direction of the Financial Regulator, are not liable in any civil proceedings for any act done, or omitted to be done, by the person for the purposes of, or in connection with, performing or exercising any function or power imposed or conferred on the Financial Regulator by or under the Act if the act was done, or was omitted, in good faith for the purposes of the Act.

⁷⁸ Section 100(1)

■ KEY CONTACTS

A large number of lawyers in our Finance and Tax Departments advise on an extensive range of securitisation transactions. The firm acts for originators, arrangers, issuers, trustees and rating agencies. Arthur Cox advised the originator on the first securitisation of Irish mortgage assets which was completed in 1995. More recently, the firm has advised the arranger of the only two mortgage covered securities programmes established under the Asset Covered Securities Act 2001.

For information on securitisation, or if you would like to discuss any of the matters covered herein, please contact one of the following Arthur Cox lawyers:



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