

Securitization in Israel

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I. INTRODUCTION

Securitization is a financing instrument that has been used in the West for many years. In transactions of this kind, a business that has many debtors sells all or some of the indebtedness of its debtors to a third party. These debts are repaid in monthly installments to the third party over many years, and the third party pays the seller a lump sum. The third party, the buyer, is usually a corporation created specifically for the purpose of the securitization transaction. This corporation has no business history, and the certificate of incorporation prohibits any future transactions, apart from the securitization transaction for which the corporation was created. This designated corporate entity, generally known as a special purpose vehicle (SPV), issues debentures or stock to raise money on the capital market. From the legal perspective, the issuance of debentures on the stock exchange constitutes a loan. The SPV borrows money from the public and creates a security interest in the only asset it owns—the financial rights it acquired from the seller. As in other issuances of debentures, the security interest is created by appointing a trustee. In some cases, the money is raised on the stock exchange through the issuance of stock. Either way,

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the SPV uses the money borrowed or raised to pay the seller for the interests it acquires.

As mentioned, the SPV's certificate of incorporation bars the SPV from transacting any other business other than the purchase of financial assets from a specific seller; these are the only assets that the SPV owns. Therefore, the SPV is not expected to post any financial losses or have any new creditors. Given the low risk involved in SPVs, they normally receive a relatively high credit rating, which facilitates the distribution of SPV stock or debentures.

In addition to the sale agreement, the seller and the SPV also execute a service agreement. The SPV has no employees and is unable to collect the debts it acquired from the seller independently. The seller, on the other hand, is specialized in its field, has communication channels with its debtors, and has an efficient collection system. The seller and the SPV enter a service agreement whereby the seller provides the SPV with collection services in consideration of an agreed payment. Under this agreement, the seller continues to collect the debts, holds the money in trust for the SPV, and transfers the money to the SPV as soon as possible. This trust structure bars the seller's creditors from arguing that the SPV is an ordinary creditor, rather than simply a holder of a property right.

The seller does not issue stock or debentures to the investors directly, because this would expose the investors to the risks inherent in the seller's general and ongoing operations and create competition between the investors and the seller's other creditors. The SPV isolates the seller's rights against the debtors from the seller's other assets, and prevents the SPV's ordinary creditors from collecting against these rights.

Securitization started in the mortgage sectors of Great Britain and the United States. These transactions were called "secondary mortgages," rather than primary mortgages, which are secured loans granted by banks or other lenders to home buyers. Securitization then spread to other businesses that had financial means or long term accounts receivables. Examples of securitized assets include the indebtedness owed to suppliers by issuers of credit card transactions and the financial rights of an industrial plant against its existing and future customers.

The first securitization transactions in Israel took place a few years ago, mostly in the mortgage sector. The first part of this paper will focus on the securitization of mortgages and will also explain the problems characteristic of such transactions. The second part of this paper describes the standard structure of securitization transactions in Israel, analyzes them from a legal perspective, and addresses additional questions, such as registration and notice to borrowers. The third part of this paper deals with an issue of great practical significance: the need to register the SPV as a mortgagee in order to perfect the mortgage.

Securitization is seen in Israel in two other areas. First, automobile leasing companies and local governments have recently started securitizing their accounts receivables. Leasing companies lease various assets, mainly cars, in consideration of monthly payments by the lessees, for an average period of three to five years. Several leasing companies started to securitize this indebtedness. This securitization takes place through an SPV. The SPV creates a buffer between the leasing company and the investors. The competition in the leasing industry in Israel is fierce, and a leasing company might face financing problems if it is unable to lease all of its fleet. These problems do not affect the SPV, which is not exposed to the company's general business operations; the SPV only acquires the rights that the leasing

company has against existing customers. At the end of 2004, a small leasing company collapsed after the controlling shareholder embezzled the money he had received from lessees, which the leasing company was supposed to hold in trust for the SPV. This affair exposed the need for appropriate monitoring and slowed down the securitization process in the leasing industry. The investors, however, did not suffer any materially adverse effect and continued to receive the leasing fees paid by lessees thereafter.

The second sector in which securitization transactions have become popular in Israel is local government. The local government initiates development programs and then requires financing that exceeds the income it generates from both taxes and the contribution of the central government. Until recently, the exclusive source of financing used in these cases was loans from commercial banks. A few years ago, many local governments encountered financial difficulties, causing the banks to increase their interest rates. Consequently, the local governments started to raise money on the capital market. A strong local government can issue municipal bonds without collateral. Several local governments have recently securitized their income from the municipal tax revenue expected over the next few years, or on the future income from real estate, such as parking lots. Once local governments discovered this alternative method of financing, the banks reduced their interest rates almost immediately.¹

As noted, securitization only started in Israel a few years ago. The relevant legislation is scarce, and most problems that emerge in this field must therefore be resolved through the general body of law. The most important law in this context is the 1969 Transfer of Obligations Law. There is still no case law addressing securitization, except for one case relating to the securitization of rights against lessees of automobiles.² The securitization transactions that took place in Israel in the last few years were not as complex as those implemented in other countries. The Tel Aviv Stock Exchange has yet to issue debentures or shares of SPVs. When SPVs were being created, the players did not raise money from the general public through the stock exchange, but rather from institutional investors through private channels. It seems, however, that the first public issuance in the mortgage sector is forthcoming.

II. SECURITIZATION OF MORTGAGES IN ISRAEL

A. *Description*

In Israel, mortgage banks are not authorized to provide general banking services, only loans to the public for the purpose of buying real estate. Most of these banks are subsidiaries of commercial banks. Recently, two mortgage banks were merged into their parent companies, so that the mortgage area is now managed by a separate division within the bank.

1. I believe that the securitization of future tax earnings by these governments gives rise to serious legal issues, because the debtors whose indebtedness is being transferred are unspecified debtors who will reside in that locality in the future. However, that issue extends beyond the scope of this paper.

2. CC 2146/04, Civil Motions 8120/04, Deloitte & Teuche (Israel) Brightman Almagor Trusts Ltd. v. Israel Discount Bank Ltd., Takdin, DC 2005(3) 10575.

The banks lend money to the public for the purchase of real estate—homes in most cases. Against the loan, the bank receives a mortgage on the borrower's property, usually the real estate acquired with the loan. In a securitization transaction, the mortgage bank sells rights it has against specific borrowers to an SPV which is created for the securitization transaction. Under the rules of the Bank of Israel (Israel's central bank), a mortgage bank may not sell only strong loans—i.e., loans with a low probability of default—and maintain only the weak loans, because this might undermine the bank's stability. The bank must therefore sell the SPV a portfolio representative of all its borrowers. An exhibit attached to the sale agreement specifies the names of the borrowers whose obligations to make future payments are sold to the SPV. In the standard securitization transaction in Israel, the mortgage bank and SPV stipulate that if a borrower defaults, the SPV will have no recourse against the bank.

The SPV has no tools to handle the logistics of loans. The bank thus provides these services for the SPV for an agreed fee. The services include management of the loans, ongoing communications with the borrowers, collection of the debts, and foreclosure of the mortgages. Since the sale agreement transfers the ownership of the loans portfolio to the SPV, the bank acts as an agent for the SPV. The service agreement provides, generally, that the bank will collect the money from the borrowers on behalf of the SPV and transfer the money collected to the SPV on agreed dates.

Securitization offers the banks various advantages. The immediate payment enables the bank to expand its business. There is also an advantage to the bank's accounting, since the loans no longer appear on the balance sheet. The institutional entities that finance the SPV are corporations with high liquidity and substantial resources—such as pension funds and insurance companies—that are always looking for new investment avenues. Under the securitization agreement, the mortgage bank acts as a mediator in the financing sector and entitles the investors to repayment of the loans and the interest acquired by the borrowers.

The SPV and its lenders, the debenture holders, want to make sure that events that might take place after the transaction will not have an adverse effect on the future cash flow from the borrowers. The SPV is concerned about the following scenarios:

Insolvency of the bank. The goal here is to prevent a receiver or an administrator from taking possession of the money paid by the borrowers. The SPV seeks to stop this money from becoming part of the receivership asset pool, and to make sure that it both belongs to the SPV and is available to the debenture holders. The SPV also wants to ensure that the bank's creditors cannot impose liens on the money owed by the borrowers.

A conflicting transaction by the borrower. The borrower might execute a transaction in violation of the mortgage with the bank, such as a transfer of ownership or any other right in the property to a third party. The bank will prevail over such competition because it is named as mortgagee in the Land Registry. The SPV seeks to have the same priority.

Insolvency of the borrower. Before the securitization, the bank is a secured creditor, and has priority over the borrower's other creditors upon insolvency. This priority is guaranteed by the mortgage, which enables the bank to foreclose on the

mortgage directly without having to first obtain court approval.³ The SPV seeks the same protection.

B. Securitization as an Assignment of Rights

To check whether the SPV and the investors can accomplish these goals, the transaction between the bank and the SPV must be analyzed in accordance with the set of laws governing it. To this end, I will now provide a brief review of the laws regulating the assignment of rights.

Generally, a creditor can sell his rights or use them as a security interest. That is, a creditor can either sell his rights or take a loan, submitting his rights against his debtors to the lender as collateral. In a sale of rights, as in the sale of movable or immovable property, the object of sale ceases to be the property of the seller, and becomes that of the buyer. Ownership of the right transfers to the assignee even without any notice to the debtor.⁴

The other transaction, in terms of security interests, is known as a pledge, meaning “a charge on property as security for an obligation.”⁵ In the law of Transfer of Obligations it is called a “transfer of a right by way of a charge”⁶ In a sale of rights, the assignee is the buyer; whereas in an assignment by way of a charge, the assignee is a secured creditor, and the assignor’s other creditors are unsecured creditors. Under the laws regulating security interests, a secured creditor prevails over all other creditors if its security interest is registered in a public registry.⁷

After the assignment, a creditor of the assignor cannot impose a lien on the transferred rights. In a true sale, the assignor is no longer the owner of the rights, which are henceforth no longer exposed to the imposition of liens by the assignor’s creditors.⁸ An assignee who is a secured creditor and has registered the security interest also prevails over the holder of a lien.

Insolvency of the assignor is not supposed to have any adverse effect on the assignee. The assignor’s receiver cannot add the assigned rights to the general asset pool, because these rights have become the property of the assignee. This rule applies even if the payment of the assigned debts is due only after the receivership order is handed down against the assignor.⁹ The same is true of an assignment by way of a charge.

3. Pledges Law, 5727-1967, 17 LSI 44 (1967)(Isr.) § 17 (stating “a pledge deposited as specified in section 4(2) and serving as security for an obligation towards a banking institution, within the meaning of the Bank of Israel Law, 5714-1954)[sic], can be realized by such institution without an order as aforesaid”).

4. CA 5578/93 Nadav v. Sargovi [1995] IsrSC 49(2) 459, 470 (holding that under Israeli law, ownership of the right transfers upon execution of the assignment agreement, and there is even no need to notify the debtor in order for the transaction to be completed).

5. Pledges Law § 1(a).

6. Transfer of Obligations Law, 5729-1969, 23 LSI 277 (1968-69) (Isr.) § 1(b).

7. Pledges Law, *supra* note 3, § 4(3); Companies Ordinance (New Version), (1983) (Isr.) § 178.

8. CA 165/75 Levinger v. Ramat Gan Zoology Park Ltd., IsrSC 30(2) 75; CA 568/85 Bank Hapoalim (Switzerland) Ltd. v. First International Bank of Israel’s Trust Company Ltd., IsrSC 32(4) 507; CA 2328/97 Kochavi v. Arenfeld, 53(2) 353.

9. CA 142/70 Shmueli v. Receivers of the Iron Company Ltd., IsrSC 24(2) 446.

However, the status of the assignee as a buyer is better than the assignee's status as a secured creditor. For instance, the court has the power—as part of the process of helping a company under receivership to recover—to suspend the exercise of security interests, provided that the secured creditor's rights are adequately protected.¹⁰ Yet the court has no authority to violate, even temporarily, the rights of an assignee who purchased the company's rights against third parties. Also, if the rights are assigned via a security interest, the assignee must repay the assignor any money collected from the debtors in excess of the loan.¹¹

It is not easy to define the criteria with which to distinguish between a true sale from a security interest. Israeli case law on this matter is scarce. According to the existing case law, if the assignment agreement provides that an assignor who is unable to collect the debt from the debtor has no recourse against the assignor, then the transaction is a true sale, and if the assignee can collect against the assignor, it is a security interest.¹²

Indeed, if under the assignment agreement, an assignee who is unable to collect the debt has no recourse against the assignor, the transaction fails to satisfy all the elements of the laws of security interests. Under the Pledges Law a security interest is incidental to the debt—it secures the debt but does not replace the debt.¹³ A lender who received a security interest and whose debt is not wholly satisfied may exercise the security interest and collect its debt from the proceeds, file a regular suit against the lender to repay the debt, or do both.¹⁴ That is, a lender that received a security interest may, at its discretion, seek repayment of the loan from the borrower without exercising the security interest. If the assignee may not sue the assignor, then their relationship is not one of lender and borrower. Israeli law does not recognize an *in rem* security interest, under which there is no duty upon the borrower to repay the debt. Parties cannot create such an interest in contract, because the list of property rights protected by law is finite—the courts are not authorized to recognize a property interest that was not recognized by the legislature.¹⁵

I will now analyze the securitization transaction under the principles governing the transfer of obligations. The bank has contractual rights under the loan agreements to receive various amounts of money from the borrowers and may assign these rights to the SPV. “The right of a creditor . . . is capable of being transferred without the consent of the debtor, unless its transferability is negated or restricted by

10. Companies Law, 5759-1999, 44 LSI 1 (1999) (Isr.) § 350(b).

11. See, e.g., Major's Furniture Mart Inc. v. Castle Credit Corp., 602 F. 2d 538, 542 (1978) (analyzing the Pennsylvania Code, which states that “[i]f the security agreement secures and indebtedness, the secured party must account to the debtor for any surplus, and unless otherwise agreed, the debtor is liable for any deficiency”).

12. See, e.g., CC 3113/88 Prinir Ltd. (In Receivership) v. Bank Leumi Ltd., IsrDC (unpublished) (“If this were an absolute assignment, then upon its execution, the assignor's obligations are terminated; but this transaction allows for the bank to collect against the assignor in case the assigned right is defaulted upon.”); see also CA 3966/01 Yehoshua TBWA v. Bon Mart Millennium Ltd. (In Receivership), IsrSC 57(4) 952; see generally S. Lerner, *Assignment of Obligations*, in LAW OF OBLIGATIONS—GENERAL PART 284-90 (2002) (stating that recourse against the assignor does not necessarily mean the transaction is a security interest rather than a true sale).

13. Pledges Law § 7.

14. *Id.* § 23.

15. See CA 46/74 Mordov v. Schechtman, IsrSC 29(1) 477 (regarding property rights as a finite list); accord J. WEISMAN, LAWS OF PROPERTY: GENERAL PART 75-87 (1993).

law, by the nature of the right or by agreement between the debtor and the creditor.”¹⁶ Therefore, if the agreement between the borrower and the bank does not prohibit the latter from transacting in the rights, the bank may assign its rights against the borrowers to an SPV. In this transaction, the bank is the assignor, the SPV is the assignee, and the borrowers are the debtors. The outcome of the assignment is that the assignor ceases to be the debtor’s creditor, and the assignee becomes the debtor’s only creditor. After the agreement between the bank and the SPV is executed, the SPV is the creditor of the borrowers, who now have no obligation toward the bank. From a contractual perspective, the SPV becomes the borrowers’ creditor—instead of the bank. From the perspective of property law, the SPV becomes the owner of the rights.

As a creditor of the various borrowers, the SPV may assign its rights without their consent. The pledging of the rights to the investors who lend money to the SPV constitutes an additional assignment. But this assignment is by way of a charge. The issuance of debentures on the stock exchange is a loan that the SPV receives from the investors, and the SPV transfers the rights it has against the borrowers as a security interest.

The assignment of the bank’s rights to the SPV protects the latter from an exposure to any insolvency of the assigning bank or the imposition of a lien by one of its creditors. This protection also applies in the case of an assignment by way of a charge. However, as a purchaser, the rights of the SPV are better protected, as are the interests of its investors. In fact, it is in the bank’s best interest to perform a true sale, because of accounting considerations. After a true sale the bank no longer needs to include the rights against the borrowers in its balance sheets, which in turn may improve its capital adequacy ratio.

In mortgage securitizations in Israel, it is standard to include a provision that expressly stipulates that if the SPV is unable to collect the debt from the borrowers, the SPV will not be entitled to demand that the bank repay the entire principal—the money it paid to the bank for the assignment. Typically, the bank only assumes liability for a very small portion of the principal. Only a full right of recourse that would expose the bank to an obligation to repay the entire amount will be interpreted as a security interest transaction. The typical securitization transaction in Israel is structured as a true sale.

C. Registration of the Assignment

In case of bankruptcy or receivership, the interests of a secured creditor will not be protected unless the assignment has been registered. Section 97 of the Bankruptcy Ordinance stipulates the following:

- (a) Where a person has transferred existing or future rights to another and is subsequently adjudged bankrupt, the transfer shall be of no effect against the trustee as regards claims which were not settled before the commencement of the bankruptcy unless the transfer was registered at the time and in the manner prescribed by regulations.

16. Transfer of Obligations Law § 1(a).

(b) The provisions of subsection (a) shall not apply to a transfer of claims against debtors specified in the instrument of transfer and the due date of settlement of which coincides with or precedes the time of the transfer, or in existing or future rights under contracts specified in the instrument of transfer, or of rights the transfer of which is included in the transfer of a business in good faith and for consideration.¹⁷

Section 97 imposes a duty of registration with respect to a general assignment that does not specify the contracts to which the assignment applies or the names of the debtors. The registration requirement does not apply where the contracts or debtors are specified in the instrument of assignment.¹⁸ If the names of the borrowers whose debts are assigned are adequately specified, the true sale transaction does not have to be registered. Typically, an addendum to the agreement between the bank and the SPV specifies the names of the borrowers and the dates of their contracts with the banks.

D. Notice to the Debtors

As a rule, the agreement between the bank and the SPV does not require the borrowers' consent. The laws governing the assignment of rights do not obligate the assignor or the assignee to notify the debtor of the assignment. However, notice to the borrowers of the assignment could strengthen the SPV's protection. A debtor may not raise claims against the assignee arising from other transactions he has with the assignor if these claims accrued after notice of the assignment was given.¹⁹ Some borrowers, especially those who also have savings plans or provident funds at the bank, may also have various causes of action against the bank. Notification to the borrowers regarding the assignment protects the SPV against any new arguments that the borrowers may have against the bank.

A special provision passed into law in 2003 with respect to the securitization of mortgages states the following: "Should a mortgage be registered under this Section, the transferring corporation shall immediately give notice of the transfer to the borrower and the owner of the real estate securing the registered mortgage."²⁰ The notice requirement applies regardless of whether the mortgage registry is amended. The purpose of the law is to protect the borrower/owner of the real estate that serves as mortgage in the case of securitization. The notice affects the protection granted by law to the borrower/owner, and therefore the borrower/owner must be notified.

Under the laws of assignments, "[t]he transfer of a right does not alter the right or the conditions thereof."²¹ Therefore, provisions allowing early mortgage payoff will remain in full force and effect. The duty to send the borrowers periodic reports no longer rests with the bank, but with the SPV. Such reporting is not an independent duty of the bank but an incidental duty to the ownership of the right

17. Bankruptcy Ordinance (New Version), 5740-1980, 3 NV 131 (1981) (Isr.) § 97.

18. Regarding the cancellation of a general, unregistered assignment, see CA 596/86 Yehudit Ben Zion v. Gorni-Trustee for the Assets of Yehoshua Ben Zion, IsrSC 43(2) 460.

19. Transfer of Obligations Law § 2(c).

20. Settlement in the State Economy (Amendments Designated to Accomplish the Budget and Economic Policy Goals for the Fiscal Year of 2003), 2002, § 46(b).

21. Transfer of Obligations Law § 2(a).

against the borrowers, and the duty transfers to the SPV accordingly. Under the service agreement, reporting will continue to be carried out by the bank.

E. The Bank as Trustee

The bank and the SPV execute a service agreement under which—in consideration of an agreed fee—the bank will continue to collect the money from the borrowers, and transfer it to the SPV shortly thereafter. The bank might be liable toward the SPV if it is negligent in collecting the money. This liability has no effect on the classification of the assignment agreement as a true sale or as a security interest. Keeping the service agreement as separate from the sale agreement might help thwart any allegation that the transaction was not a true sale.

From a property law standpoint, the money held by the bank is the property of the SPV. In one instance, Israel's Supreme Court expressed its opinion that where the debtor paid the debt to the assignor instead of the assignee, the assignor was holding the money in trust for the assignee.²² The standard service agreement used in Israel expressly stipulates that the bank is a trustee for the issuer.

The creditors of a trustee have no recourse against the assets held in trust. The Trust Law states: "Trust property shall not be distrained save for debts resting on that property or arising out of activities of the trust."²³ Thus, the bank's creditors have no access to the money that the bank holds in trust for the SPV: "A trust has effect vis-à-vis any person who knows or ought to know about it, and where a note has been entered under section 4, vis-à-vis the whole world."²⁴ If the bank is dissolved, the receiver might argue that the trust agreement between the bank and the SPV is not binding upon the receiver, because the receiver was not aware of its existence.

In order to protect the trust, the following actions can be taken:

- a. Incorporating a provision in the service agreement that expressly states that the bank will hold the money obtained from the borrowers in trust for the issuer or the investors;
- b. Holding the money received in a separate trust account and prohibiting the bank from transacting in this money in any way—apart from a transfer to the SPV;
- c. Registering the transaction between the bank and the SPV with the Companies' Registrar. Such registration could inform third parties of the SPV's rights and thus satisfy the requirement regarding third parties' knowledge as required to protect the trust.

III. MAKING THE SECURITY INTERESTS AVAILABLE TO THE SPV

The underlying loan agreement between the bank and the borrower gives the bank a mortgage over the borrower's real estate. This mortgage is evidenced in the Land Registry and grants the bank priority over the other creditors if the borrower

22. CA 4724/90 ESHET Finance Ltd. v. United Mizrahi Bank Ltd., IsrSC 46(3) 570, 577.

23. Trust Law, 5739-1979, 33 LSI 154 (1978-79) (Isr.) § 3(b).

24. *Id.* § 5.

becomes insolvent. Also, if the borrower executes a transaction that conflicts with the mortgage the bank will prevail. This section discusses the ways that the SPV can get such priority as well.

Under the laws governing transfers of obligations, along with the assigned right, the assignee also receives incidental rights. Unless the parties expressly stipulate otherwise, incidental rights and obligations transfer along with the principal right that is being transferred. Section 5 of the Transfer of Obligations Law states:

Subject to the transfer agreement, the transfer of a right includes any guarantee or charge given as security for it and any other right concomitant to the transferred right, as far as they are transferable; and the creditor shall, upon the demand of the transferee, do the acts necessary in order that the transfer of the said rights may be valid in all respects.²⁵

This provision implies that the security interest is transferable under the law, regardless of the consent of the debtor in the underlying transaction.²⁶ An assignment that does not include the security interests securing the right reduces the value of the transferred right. Requiring a debtor's consent conflicts with the key principle of the laws of transfer of obligations—that rights can be transferred swiftly without the debtor's consent.²⁷

The SPV is therefore entitled to be the named mortgagee in the Land Registry, and may ask the Land Registry to amend the registration in accordance with Section 87 of the Land Law. The 1974 Land Regulations (Fees)²⁸ stipulate the fee payable for such an amendment. Under Section 87 of the Land Law, a mortgage cannot be transferred if the underlying loan agreement between the bank and the borrower prohibits the transfer.²⁹ However, the language of most loan agreements in Israel does not include such prohibition. In practice, the Land Registrar does not check the terms of each loan agreement and makes do with a confirmation by the company and an affidavit drafted by its legal counsel certifying that “[under] the terms of the mortgage, the consent of the owner of the land is not required in order to transfer the mortgage.”³⁰ Once the Registry is amended, the SPV becomes the mortgagee and has the same legal status as the bank did prior to the transfer. The SPV's mortgage is considered a continuation of the original mortgage, rather than a new one.³¹

25. Transfer of Obligations Law § 5.

26. For example, the SPV will be assigned guarantees that third parties have made to secure the borrowers' loans.

27. CA 886/97 *Burstein v. Hudad*, IsrSC 52(4) 68 (holding that the debtor's consent is not required in order to assign the incidental rights). This proposition is reflected in U.S. law, according to which a mortgage securing a specific debt transfers to the assignee to whom the debt is assigned, even if the assignee is unaware of the existence of the mortgage based on the documentation. See *RESTATEMENT (THIRD) OF PROPERTY* § 5.4 cmt. c (1997) (stating “the obligation will ‘follow’ the mortgage even if not expressly mentioned in any document of transfer . . . this section is designed to carry out the parties' intention even though they, through ignorance or inadvertence, have not fully documented it”).

28. The Land Regulations (Fees), 1974, add. § 2(b)(1).

29. Land Law, 5729-1969, 23 LSI 283 (1968-69) (Isr.) § 87.

30. Settlement in the State Economy Law § 46(a)(1).

31. Motion 859/95, CC (TA) 1898/94 *In Re* Dov Fischler, Adv. v. Shekel Leasing Ltd., Takdin, DC

That said, an amendment of thousands of mortgage registrations involves a considerable fee, possibly hindering the use of securitization transactions. It is therefore important to understand the legal status of an SPV that decides not to amend the Registry, leaving the bank as the named mortgagee. This subject has not been addressed by the courts yet. It is my opinion that the SPV is a secured creditor, whether or not the Registry is amended to state that the SPV is the mortgagee instead of the bank.

Section 5 of the Transfer of Obligations Law says that security interests that the assignor had transfer to the assignee as part of the assignment. The law adds that “the creditor shall, upon the demand of the transferee, do the acts necessary in order that the transfer of the said rights may be valid in all respects.”³² This language seems to indicate that various complementary actions are required in order to give the security interest full force and effect in the hands of the assignee. According to this reading, the assignee is secured by the security interest only after the Registry is amended. I argue that this interpretation is undesirable and should therefore be rejected.

The mortgage transfers to the SPV under Section 5 and under the agreement between the bank and the SPV. At this point the SPV is the holder of an unregistered mortgage. In 1999, Israel’s Supreme Court opined that the purchaser of real estate has a right in equity even before the Registry is amended to reflect the new ownership or before a warning (a “caveat,” known in Hebrew as *he’arat azhara*) to third parties that a contract has been executed for the sale of the property is entered in the Registry.³³ Based on this logic, the Court prioritized a purchaser over a creditor of the seller that has a lien on the property.³⁴ This decision changed the previous precedent, according to which until the transaction was entered in the Land Registry, a purchaser of land was not considered to have a proprietary right but only a contractual right. In another decision, delivered toward the end of 2003, the court held that the equitable right that a buyer had before the transaction that was perfected by registration also protects such buyer against insolvency of the seller.³⁵ The buyer has priority over the other creditors of the insolvent seller and is entitled to receive the title to the real estate. In other words, the execution of an agreement for the sale of real estate in and of itself gives the buyer priority, and the transacted real estate will not be part of the pool of assets available to the creditors.

The above case law raises questions about the unregistered mortgage. The Supreme Court deduced the existence of an equitable right from Section 9 of the Land Law, which, in addition to sale transactions, also governs a covenant to register a mortgage.³⁶ The Supreme Court has not addressed this issue yet, and the district

96(3) 3792.

32. Transfer of Obligations Law § 5.

33. CA 189/95 Bank Otsar Ha-Hayal v. Aharonov, IsrSC 53(4) 199.

34. *Id.*

35. CA 3911/01 Caspi v. Shlomo Ness as Trustee in A Creditor Workout for “Diyur La-Oleh”, IsrSC 56(6) 752.

36. Land Law § 9 (stating “[w]here a person has undertaken to effect a transaction in immovable property, and before it is completed by registration he undertakes towards another person to effect a conflicting transaction, the right of the party to the first transaction shall prevail: Provided that if the party to the second transaction has acted in good faith and for consideration, and such transaction is registered while he is still in good faith, his right shall prevail.”).

courts have expressed varying views.³⁷ I agree with the approach that recognizes the enforceability of an unregistered mortgage. The case law supporting the other approach does not offer any theoretical basis for the distinction between the unregistered right of a buyer and the unregistered right of a mortgagee.

The SPV's priority also arises from Section 4(3) of the Pledges Law. According to this Section: "A pledge shall be effective against other creditors of the debtor . . . upon the registration of the pledge in accordance with regulations made under this Law: Provided that against a creditor who knew or should have known of the pledge it shall be effective even without registration."³⁸ Registration of the bank as mortgagee in the Land Registry gives the borrower's creditors knowledge of the transaction. Therefore, even if the right is assigned to the SPV but the mortgagee as named in the Land Registry is still the bank, the mortgage is deemed an unregistered security interest—which has full force and effect if the borrower becomes insolvent. The original registration informs third parties of the mortgage. Entries in the Land Registry are according to parcels and blocks, and the fact that there is now a different creditor is irrelevant to the fact that a mortgage on the same parcel or block still exists.

There is similar case law regarding subrogation in favor of a guarantor. A guarantor that repaid the debt has a right to claim the payment from the principal debtor, and the security interests that secured the creditor henceforth protect the guarantor instead.³⁹ Like Section 5 of the Transfer of Obligations Law, Section 12 of the Guarantee Law provides that "the chargor and the creditor shall, at the guarantor's request, do the acts necessary to make the transfer valid in all respects."⁴⁰ In one case it was argued that unless the security interest was not registered to the guarantor in the appropriate registry, the guarantor had no recourse against the collateral.⁴¹ The Court ruled that the assignment of the collateral is consistent with the sense of justice and that such assignment has full force and effect even before it is reflected in the registry.⁴² This decision reflects the policy of recognizing the effect of the security interest even before it is registered to the new creditor. This approach, in the Court's view, does not prejudice the rights of the debtor's other creditors, because even before the assignment they could not collect against the collateral.⁴³

Similar case law exists regarding security interests. The Pledges Law enables the debtor, or any other person who would be adversely affected by the liquidation

37. See, e.g., CA 1370/01 Kidma Ltd. V. Levy-Tuhrer, Attorneys at Law, Isr Dinim DC 32(10) 461; CC 1256/02 Sharon, Adv. v. Alphasim Shimon, IsrDC 2002(3) 7502. Cf. CC (Jer) 2247/03 Reshef v. Levy, Takdin DC 2004(1) 6761.

38. Pledges Law § 4(3).

39. Guarantee Law, 5727-1967, 21 ISR 41 (1966-67) (Isr.) §§ 9, 12.

40. *Id.* § 12.

41. CA 108/59 Pritzker v. Niv. Ltd. (In Liquidation), IsrSC 14, 1545.

42. *Id.*

43. See, e.g., CA 306/68 The Official Receiver v. Receiver of Palkoltit Ltd., IsrSC 23(1) 256. (holding that a guarantor that repaid a debt that has priority by law, such as taxes, is entitled to the same priority). "Actually, what would the debtors be losing if the priority passes from the creditor to the guarantor? Nothing. The creditors' rights are not violated by the prioritization of a guarantor who paid the debt, because the debt that he paid had priority over their debts in the first place, and the change in the identity of the payee has no effect on their interests.")

of the collateral, to recover the collateral by paying the secured debt.⁴⁴ Section 14 of the Pledges Law provides that:

Where a pledge has been redeemed . . . by a person other than the debtor, the person redeeming is entitled to resort to and be recouped by the debtor in like manner as a guarantor who has fulfilled his guarantee, and if the person redeeming is not the owner of the property, the pledge shall be available to him for securing that right.⁴⁵

In other words, the security interest that secured the creditor's rights shall protect a third party that satisfies the debt. As compared to Section 5 of the Transfer of Obligations Law, this provision does not stipulate that the parties must amend the registration to name the payer as holder of the security interest. Here too, the Court held that the entity that redeems the collateral shall have priority over other creditors, even before the registration is amended.⁴⁶

The principle that an assignment of a right that is secured by a security interest does not require registration of the assignee as the secured creditor is also the standard in U.S. law⁴⁷ and in the province of Ontario, Canada.⁴⁸

To conclude, the interests of the SPV will not be adversely affected if the registration is not amended to reflect the transfer to the SPV, and even without such amendment the SPV will be deemed to be the holder of a perfected security interest in the borrower's property. Even though according to the Registry, the mortgage secures the bank, the mortgage secures the indebtedness of the borrower toward the SPV. In case the borrower becomes insolvent, the SPV will have priority over other creditors.

If the bank is solvent and the borrower becomes insolvent, the bank will exercise the mortgage as an agent for the SPV. The service agreement between the SPV and the bank should make provisions to this effect. An argument by the borrower that the bank is not the mortgagee and may not exercise the security interest will be rejected because that the bank is seeking exercise as an agent for the SPV is irrelevant to the borrower. However, the service agreement should also stipulate a mechanism by which the SPV can exercise the mortgage through another entity in case the bank becomes insolvent.

44. Pledges Law § 13(b).

45. *Id.* § 14.

46. CC 151/93 Leumi Mortgage Bank Ltd. V. Asher Haviv, IsrDC 5756(2) 370.

47. See RESTATEMENT (SECOND) OF CONTRACTS § 340 cmt. b (1981) (stating “[w]here a secured claim is assigned, the collateral is ordinarily assigned as well,” inferring that registration is not required to effectuate the assignment of the security interest).

48. See Personal Property Security Act, 1990 R.S.O., ch. P.10 (Can.) § 47(1) (inferring an automatic assignment of the collateral when the security interest is transferred “where a security interest is perfected by registration and the secured party has assigned the secured party’s interest in all or part of the collateral”).

IV. SUMMARY AND CONCLUSIONS

This paper reviewed the introduction process of securitization to the Israeli marketplace. This process started in three areas: mortgages, securitization of the indebtedness in leasing transactions, and securitization of tax money owing to local government. We focused on the securitization of mortgages and the legal issues surrounding such transactions.

The popularity of securitization depends on economic factors. A low financial margin in the mortgage sector would hinder securitization, because it would leave no profit to be divided between the bank and the SPV. But economic factors are not the only possible hindrance—judicial uncertainty might also hold back the development of this market. Since the legislature has not given much thought yet to this financing instrument, an analysis must be made based on the general provisions of the law.

In 2005, a government committee examined the local securitization market and recommended the adoption of a designated statute that would regulate the field. Such special legislation would answer the main issues reviewed above:

Protection of the debtors whose indebtedness has been securitized. This protection is particularly important in the mortgage industry. Generally, when borrowers default on their loans, mortgage banks work out arrangements with the borrowers—such as debt rescheduling—which help borrowers avoid final breach. The loan agreement does not oblige the bank to make such concessions, but this is nevertheless standard practice. Securitization transactions give rise to the concern that the SPV would not be as considerate to the borrower. The bank intends to stay in the mortgage industry in the long-term, and looks out for its reputation. The SPV, on the other hand, is an outsider that has no incentive to make any concessions. Protection of the borrowers should therefore be regulated by statute.

Clear criteria distinguishing between a true sale and a security interest. A true sale protects the SPV more effectively, and such protection would incentivize the securitization market.

The SPV as a secured creditor even though the named mortgagee in the Land Registry remains the bank. Uncertainty might seriously undermine the securitization of mortgages because the cost of amending the registration to name the SPV as mortgagee with regard to all the assigned rights would be very high.

We hope that the committee's recommendations are accepted and that a comprehensive arrangement regulating the securitization sector passes into law. Such an arrangement would certainly give this sector a serious boost.