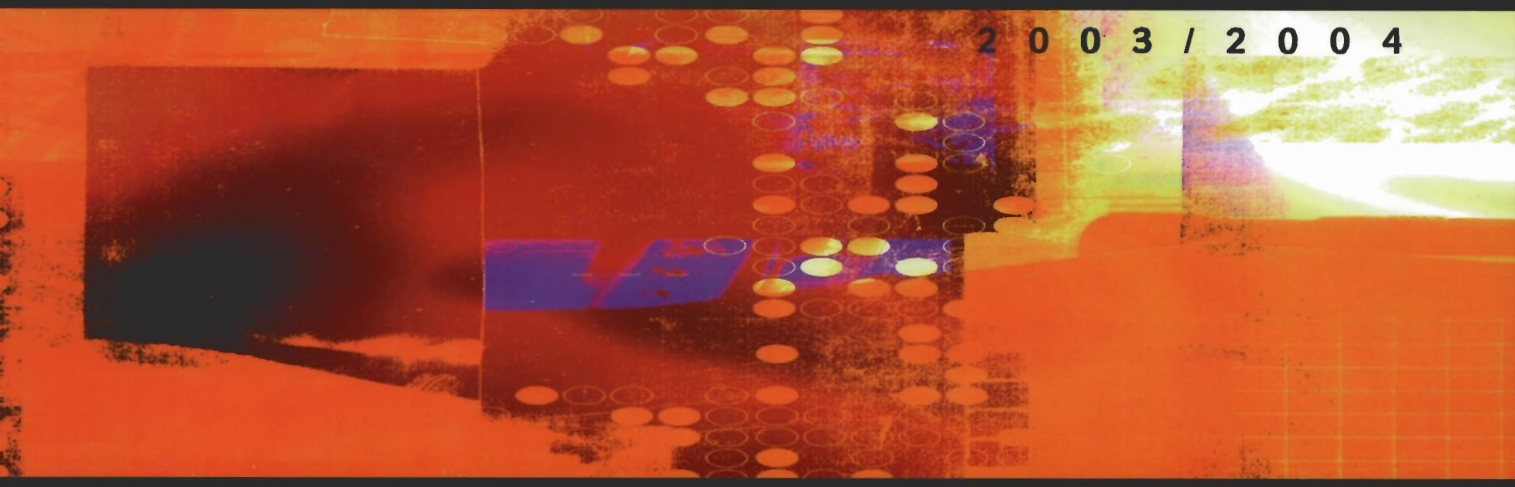
Global Securitisation Review

2003/2004



A EUROMONEY PUBLICATION

The Portuguese securitisation market

by Pedro Cassiano Santos, Paula Gomes Freire and André Figueiredo, Vieira de Almeida & Associados

Four years have now passed since the enactment of the Portuguese Securitisation Law and, after the conclusion of several and diversified transactions with a continuous growth in the volume of securitisation issuances, it can now be said that the Portuguese securitisation market has reached its first step of maturity.

Even if securitisation in Portugal has known a steady and consistent growth since July 1997, when the first securitisation deal was completed, the absence of an appropriate and specific legal framework created the need to resort to traditional civil law concepts requiring intricate, imaginative and elaborate legal structuring and tax planning.

In this context, the Securitisation Law, finally enacted on November 5, 1999, may be said to have laid down favourable conditions for the definitive expansion of the Portuguese securitisation market and this path seems to have been followed by the market. As legal advisors, we have clearly witnessed this evolution, having participated in the setting up of various transactions over the past few years.

In very general terms, the highlights of this legal framework are as follows:

1. special rules were established in order to facilitate the assignments of credits for securitisation;
2. a list of all potential originators was established;
3. the requisites of the credits that may be securitised were provided;
4. two different types of securitisation vehicles were created: (i) the Credit Securitisation Funds (*Fundos de Titularização de Créditos* – "FTC") and (ii) the Credit Securitisation Companies (*Sociedades de Titularização de Créditos* – "STC")

Notwithstanding the fact that the Securitisation Law represented a crucial instrument in the simplification of the structuring of transactions originated in Portugal, it was also true that certain provisions of the legal framework established by the Securitisation Law did not ensure the necessary flexibility this instrument required, as is well evidenced by the fact that the same was only used two years after entering into force.

Bearing this in mind, significant changes were introduced by Decree-Law 82/2002 of April 5, namely in respect of the reduction of the capitalisation requirements of the two vehicles, which are now subject to the same level of own funds requirements, and the nature and supervision of the STCs. It can now be said that the set of changes introduced in 2002 finally created the required conditions for a significant growth of securitisation in Portugal.

Assignment of credits

Under the Securitisation Law, whenever credits are assigned to one of the securitisation vehicles they will be deemed to be assigned for securitisation purposes, in which case such assignment, while at all times required to constitute a true and definitive sale, becomes subject to specific regulation, deviating from the general rules on assignment of credits. In fact, while the effectiveness of the assignment towards the debtors continues, generally, to be subject to notification of said debtors, it is now established that such notification is deemed to have occurred on the third business day following registration of the relevant letter. However, one of the most innovative features in this respect is that of the waiver of the need to notify debtors for the assignment of credits to be immediately effective towards them, when the assignor is a credit institution, a financial company, an insurance company, a pension fund or a pension fund managing company.

Of importance is also the fact that the assignment of mortgage loans for securitisation purposes is no longer required to be made by means of a notarial deed, a private document duly signed by the parties before the notary or relevant companies' secretaries amounting to sufficient title to register such assignment.

This means that the former constraints on securitisation of mortgage loans ceased to exist, something that had an immediate impact on the mortgage loans securitisation market which has registered a significant growth over the past two years, during which time a considerable number of large volume transactions were launched.

Finally and as far as assignment features are concerned, we note that key securitisation

requirements such as bankruptcy remoteness and commingling risk are adequately addressed in the new Securitisation Law, and namely that:

- proof of bad faith in the performance of certain acts which may be said to cause depletion of a given debtor's assets (such bad faith is deemed in certain circumstances as per the general terms of insolvency law) lies upon the creditor whenever such acts occur for securitisation purposes;
- unless it is bad faith driven, no assignment of credits for securitisation purposes may be challenged for the benefit of the assignor's bankruptcy estate;
- any payments made to the assignor in respect of credits assigned prior to a declaration of bankruptcy shall not form part of its bankruptcy estate even when their maturity date is subsequent to any such declaration;
- any amounts held by the servicer as a result of the collections in respect of credits assigned for securitisation purposes shall not form part of the servicer's bankruptcy estate.

What credits may be securitised

The general rule set forth in the Securitisation Law is that the generality of financial assets may be securitised, provided they meet the following requirements:

- transfer thereof may not be subject to legal or contractual limitations;
- they must be of a pecuniary nature and not be subject to any condition;
- they may not be matured credits or otherwise encumbered or charged credits; and
- no litigation may be pending in respect thereof.

An important feature of the framework regarding the credits that may be securitised is the reference to future receivables. These may be securitised provided they arise from pre-existing legal relationships and the corresponding payments are quantifiable and capable of estimate. We believe this clarification and the consequent possible use of future receivables for securitisation is most useful to those originators having credits with short maturities, as it makes the setting up of long-term transactions involving larger portfolios possible.

Securitisation vehicles

The Securitisation Law established two different types of securitisation vehicles (the FTC and the STC) and, accordingly, two different structures for the setting up of securitisation transactions. This allows for the use of the two main European legal sources of inspiration (continental and Anglo-Saxon).

The FTC structure

The FTC can be seen as a tripartite structure, involving the securitisation fund, the fund manager and the custodian, following a more continental European model.

Securitisation funds are autonomous pools of assets divided into units, held jointly by a different number of entities and presenting a variable or a fixed nature (depending on whether credits may be acquired on a revolving basis and further units may be issued or not). In no event may the securitisation funds be liable for the debts of the above entities, for the debts of the fund manager or of the entities from whom they acquired the credits forming part of such pools of assets.

Accordingly, under a concept similar to that of regular investment funds, securitisation funds are in fact structures fully dedicated to the performance of the payments under the securitisation units on the basis of the collections resulting from the relevant portfolios.

The securitisation funds are managed by fund managers, i.e. financial companies who are, *inter alia*, required to hold registered offices and effective management in Portugal, qualifying as a financial intermediary and a commercial company which is exclusively engaged in the management of one or more funds on behalf of the holders of securitisation units.

The tripartite structure is finalised with the intervention of the relevant custodian, with whom the fund's assets are required to be held.

Until now, all securitisation transactions developed in Portugal under the Securitisation Law have used the FTC structure, that has thus been used to securitise many types of financial credits from various banking originators and also the very recent (July 2003) first Portuguese corporate receivables securitisation.

The STC structure

Securitisation companies are financial companies who are, *inter alia*, required to (i) qualify as a limited liability company; and (ii) be exclusively engaged in the carrying out of securitisation transactions by means of acquiring, managing and transferring receivables and of issuing securitisation notes as a source of financing such acquisitions. They operate on terms that are similar to those of SPVs and therefore correspond to the implementation in Portugal of a more Anglo-Saxon source of inspiration for development of this type of transaction.

Good evidence of the increased expansion and competition in the Portuguese securitisation market, besides the growing number of fund managing companies, is that of the recent incorporation of the first STC, something that will surely provide for a

VIEIRA DE ALMEIDA

& ASSOCIADOS

SOCIEDADE DE ADVOGADOS

As part of its capital markets practice, the firm has provided legal advice in respect of both domestic and international securities market transactions, including the issue/placement of listed equity and debt instruments in various markets, the setting-up of Euro Medium Term Note programs and the issue of innovative equity, quase-equity and debt instruments. The firm has been involved in the main securitisation transactions executed to date in Portugal, acting as legal counsel to either originators, arrangers or purchasers.

Vieira de Almeida & Associados
Sociedade de Advogados

Rua Mouzinho da Silveira, 10

1250 - 167 Lisboa
Portugal

Tel. (+351) 21 311 34 00
Fax. (+351) 21 352 22 39

Contact: Pedro Cassiano Santos

diversification in the structures used under the Securitisation Law.

A special reference needs to be made to the bankruptcy remoteness nature of the STC. The first point to be noted in this respect is that the STC's activity may only be financed with equity or through the issuance of securitisation notes; this type of company being expressly forbidden to issue any other kind of debt instruments or to otherwise borrow from other entities outside securitisation transactions. Accordingly, besides the noteholders of each securitisation notes issuance, the only possible creditors of the STC will be the providers of services required for the development of the STC's activity which, by nature, are limited in type and number.

In addition, payments due in respect of the securitisation notes are guaranteed by the credits allocated to them (enjoying thus a privileged position over the relevant pool of assets) and, therefore, the noteholders from a given issuance are not entitled to claim against the assets backing other issuances of securitisation notes made by the STC.

In light of the above, it can be said that the bankruptcy of the STC is clearly of a remote nature which, by virtue of the own fund requirements established in the Securitisation Law and the system of legal rankings and preferences that has been provided for by the Securitisation Law, does not hinder the noteholders' entitlements to the portfolios underlying the relevant issuance of notes.

The main feature in respect of the securitisation notes issued by the STCs is thus that their reimbursement is guaranteed by the pool of credits exclusively allocated to them, i.e. they are of limited recourse to the specific assets backing the relevant issuance of notes and they enjoy a privileged position in relation to these same assets. This segregation principle means that the assets acquired by the STC constitute an autonomous and ring-fenced pool of assets which is exclusively allocated to the issuance of the securitisation notes and which is not, therefore, available to other creditors of the STCs until all the amounts due in respect of such issuance of the securitisation notes are fully paid.

The incorporation of the first STC certainly evidences that both legal routes are feasible to pursue securitisation in Portugal and may also be seen as a way of stimulating awareness of securitisation in Portugal, allowing the concept to develop to a further extent.

Supervision mechanisms

The Bank of Portugal and the CMVM (the Portuguese Securities Market Commission) are the regulatory and supervision authorities insofar as securitisation in Portugal is concerned, and the role played by these entities may be summarised as follows:

- The creation of FTCs is subject to the prior authorisation of CMVM and, whenever the credits are to be assigned by a credit institution, a financial company, an insurance company, a pension fund or a pension fund manager, the said authorisation must be preceded by a favourable opinion of the Bank of Portugal or the Portuguese Insurance Institute, as the case may be.
- The CMVM is in charge of supervising the activity of FTCs.
- The incorporation of securitisation fund managers is subject to the authorisation of the Bank of Portugal, who is also the entity in charge of their supervision.
- Having ceased to qualify as financial companies, the incorporation of STCs is only subject to a previous CMVM authorisation.
- The issuance of notes by STCs is subject to registration with the CMVM.

Tax issues

The most common criticism in respect of the Securitisation Law was originally that of the absence of a specific tax framework, something that in practical terms imposed the need to resort to tax driven complex and expensive structures. Aiming at conferring more flexibility and competitiveness to securitisation transactions and at ensuring neutrality to the various players, Decree-Law 219/2001 of August 4 was enacted to define the Securitisation Tax Regime.

In very general terms, the highlights of this tax regime are the following:

- the gains and losses arising to the originators from the assignment of credits for securitisation purposes shall be taxed under the general Corporate Income Tax (IRC), while income resulting from the assignment of credits is not subject to withholding tax on account of IRC;
- a tax exemption is in force with regard to income resulting from the assignment of credits where the assignors are, *inter alia,* non-residents in the Portuguese territory without a permanent establishment in this territory, save where the non-resident entity is directly or indirectly owned by residents or is a resident of a black listed jurisdiction;
- assignees are subject to the general regulations laid down in the IRC Code, on the basis of their taxable profits, but there is no obligation to effect

any withholding tax on account of IRC on income from assigned credits;

- the assignments of credits for the purposes of securitisation, including any possible return of assigned credits, as well as the interest collected and the use of credit granted by credit institutions and financial companies to securitisation vehicles, are exempt from stamp tax;
- the income resulting from the units and notes is subject to the tax regulations applying to bonds, which means an obligation to effect a 20% withholding tax. However, an express exemption applies where the unit and note holders are non-residents in the Portuguese territory without a permanent establishment in this territory, save where the non-resident entity is directly or indirectly owned by residents or by residents of a black listed jurisdiction.

Conclusion

The Portuguese jurisdiction currently enjoys both a legal and tax framework that may be seen as securitisation-friendly and the enactment of such a framework created a path for the market to follow.

The steady growth in the Portuguese-originated securitisation market that has been felt during the latest months certainly evidences the wide use of such a legal and tax framework, not only in terms of the number and volume of transactions, but also in terms of the nature of the assets that have been securitised (including, as mentioned, corporate receivables).

The market is thus responding favourably to the challenge presented by the legislators but this is certainly the first of many steps for securitisation in Portugal.

Authors:
Pedro Cassiano Santos
Paula Gomes Freire
André Figueiredo
Vieira de Almeida & Associados
Rua Mouzinho da Silveira, 10
P – 1250-167 Lisboa
Portugal
Tel: +351 21 311 34 79
Fax: +351 21 352 22 39
Email: PCS@vieiradealmeida.pt
PGF@vieiradealmeida.pt
AF@vieiradealmeida.pt