

The 2004 Guide to

Structured Finance



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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, quasi-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.

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2003 a landmark year for Portuguese securitization

The securitization market in Portugal is still young, but it is already producing innovative structures. Pedro Cassiano Santos and Paula Gomes Freire of Vieira de Almeida & Associados describe its progress

Securitization in Portugal grown steadily and consistently since 1997, when the first transaction originated out of Portugal was put in place.

Progress on the legal/regulatory front has swiftly been made, from the absence of a specific securitization legal framework until November 1999, to the existence, in 2004, of a legal regime that most securitization market players (raters and investors included) recognize as fully securitization friendly.

Naturally, the market/transaction front mirrored this progress.

Within only five years the Portuguese market witnessed the implementation of the first triple-A rated transaction ever (1999), the first residential mortgaged-backed security transaction (2001), the first non-banking asset-backed transaction (2003) and the first European securitization transaction involving tax claims (2003), which was also the first securitization transaction allowing for direct issuance out of Portugal (the notes being governed by Portuguese law) and listing in the Euronext Lisbon (April 2004).

And four years were enough for five competing Portuguese law securitization vehicles (four securitization fund managers and one securitization company) to be put in place.

2003 – a securitization landmark

Last year was definitely a landmark in Portugal's short securitization history, with a new record in the number and volume of transactions successfully concluded, asset and structure diversification, a groundbreaking transaction and new changes to the securitization legal regime.

Fourteen transactions in 2003, with a global issuance volume of over €10 billion, all conducted under the framework of the Portuguese securitization legal regime, is the current national securitization record.

However, of greater importance is the fact that there was significant innovation in terms of asset type and transaction structuring.

New asset type

Up until last year, all securitization transactions conducted in Portugal involved banking assets only. Naturally, banks and other financial institutions, typically hungry for lower cost liquidity and capital, were the first originators to resort to this type of instrument. The fact that corporates have followed is a sign of market maturity resulting from successfully tested experiences that show that securitization in Portugal is a ready-to-use flexible financial tool.

Galp Investment plc closed in July 2003 and was the first non-banking asset securitization concluded in Portugal. It involved the assignment of trade receivables originated by

Petróleos de Portugal-Petrol SA in the context of its normal business activity. The fact that the originator is not a bank or a financial institution means that certain features of the assignment regime vary (for example, contrary to what is the case when the originator is a bank, the assignment is not immediately effective against the borrowers when effective between assignor and assignee) and that special consideration needs to be given to a potential originator/servicer bankruptcy (as, again, bankruptcy laws applying to banks are not the same as those applying to corporates). Asset diversification has therefore meant facing new challenges and successfully overcoming new legal hurdles.

New transaction structure for

an innovative deal

In terms of transaction structure, 2003 also witnessed important innovation. All securitization transactions conducted under the Portuguese securitization legal regime until last year used a securitization fund (FTC) as the purchasing securitization vehicle and issuer of securitization units. The first (and so far unique) alternative securitization vehicle – the securitization company (STC), which issues notes instead of securitization units – was incorporated last year and used for the first time in the context of one of the most novel transactions of late – Explorer 2004 Series 1 Securitization Notes.

This transaction closed in April this year (even if the purchase of the receivables was initially funded by a private placement of notes just before Christmas 2003) and it breaks a number of novel features which include: (i) the first securitization by the Republic of Portugal; (ii) the first tax claims securitization in Europe; (iii) the first transaction using an STC structure; (iv) the first transaction using a common representative of noteholders; and (v) the first transaction allowing for direct issuance out of Portugal using Portuguese

law as the governing law for the notes.

It involved the assignment by the Portuguese Republic and the Instituto de Gestão Financeira da Segurança Social (the entity to whom social security

contributions are paid in Portugal) of tax and social security claims, respectively, originated between January 1 1993 and September 30 2003.

And although the Portuguese securitization legal regime allowed, from the beginning, the state and other public entities to assign credits for securitization purposes, the nature of the assets at stake (tax and social security credits) required the enactment of new pieces of legislation whereby certain basic principles, that is, those relating to the protection of the rights and guarantees of taxpayers, would be ensured.

New changes to the securitization legal regime

In December 2003, besides Portaria 1375-

The first (and so far unique) alternative securitization vehicle – the securitization company, which issues units instead of securitization notes – was incorporated last year

Author biographies



Pedro Cassiano Santos
Vieira de Almeida & Associados

Pedro Cassiano Santos joined the firm in 1989 and is the partner in charge of the working group specializing in financial and banking law. In such capacity, he has been involved in the structuring of several transactions, such as the issue and placement of debt and equity instruments (both national and international), and the issue and placement of warrants and synthetic and other structured finance products. He has also been actively working in securitization transactions and other types of asset backed transactions.

Pedro holds a law degree from the University of Lisbon, Faculty of Law and a post-graduate degree in European legal studies from the College of Europe, Bruges, Belgium. He is admitted to the Portuguese Bar Association. He speaks Portuguese, English, French and Spanish.



Paula Gomes Freire
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Paula Gomes Freire is an associate specializing in banking and financial law who joined Vieira de Almeida & Associados in 1996. Since then she has been involved in the preparation and execution of most of the firm's securitization transactions, since the establishment of the first Portuguese transactions in the late nineties.

Paula has a law degree from the University of Lisbon, Faculty of Law and a post-graduate degree in English commercial law from the University of London, College of Law.

Paula is admitted to the Portuguese Bar Association and to the Law Society of England and Wales (non-practising). She speaks Portuguese, English, French and Spanish.

A/2003 of December 18 2003, which set out, as required by law, the specific terms and conditions of this particular transaction (such as the nominal amount of the assigned credits, initial purchase price and servicer's remuneration), the following legislation was enacted:

(i) Law 103/2003 of December 5 2003, passed through Portuguese parliament, defining the basic legal principles applying to the assignment, for securitization purposes, of tax and social security credits. It ensures the protection of the rights and guarantees of taxpayers by setting out that such rights remain totally unaltered and that the taxpayers' personal data are to remain fully confidential. It also requires the servicing of the tax and social security credits to be ensured by the corresponding originators. This is something that not only allows for the relationship with the taxpayers to remain in exactly the same terms as before the assignment, the same proceedings and jurisdiction of special tax courts untouched. Given that the performance of a transaction of this nature is of great importance to the Portuguese government, investors will be able to take comfort from the fact that the Portuguese government retains the servicing role.

(ii) Decree-Law 303/2003, of December 5 2003, approved by the Portuguese government, amended the Portuguese securitization legal regime (approved by Decree-Law 453/99 of November 5 and amended by Decree-Law 82/2002 of April 5) and Portuguese securitization tax regime (approved by Decree-Law 219/2001 of August 4). The purpose of this further amendment was, essentially, to reflect the basic principles applying to the securitization of state and social security credits, as approved by Law 103/2003, into the general Portuguese securitization legal regime, to allow for an integrated legal definition of the terms and conditions applying to securitization in Portugal.

Given that the experience gathered in the meantime revealed the existence of certain inefficiencies within the Portuguese securitization legal regime, Decree-Law 303/2003 was also an opportunity to introduce the necessary changes to correct such inefficiencies.

In this context we would particularly highlight the following changes:

- **Possibility of securitizing assets other than credits**
 The new wording of the law expressly sets out this possibility (express reference being made to the

securitization of portfolios of bonds) but the necessary rules establishing a more specific regime are still to be defined by means of a CMVM (the Portuguese Securities Commission) regulation.

- **Possibility of securitizing overdue credits**
 Securitizing overdue credits was forbidden, but this prohibition has now been revoked. By revoking this prohibition the legislator acted wisely as the quality of a given portfolio and the risk associated to it is to be assessed by the relevant market players in light of appropriate disclosure and the rating that may have been attributed to the relevant issue. The revocation of this prohibition is another sign of market maturity.
- **No commercial registration for the issue of securitization notes**
 Until the introduction of these changes, only the issue of securitization notes qualifying as a public offer was exempted from commercial registration. Now any issue of securitization notes is exempted, and no commercial registration is required.

The public offer of securitization notes is in any case subject to prior registration with the CMVM while the private placement of such notes is subject to subsequent notice to the Commission.

- **Widening of the concept of common representative of noteholders**
 This is indeed one of the most significant and relevant changes because, although direct issuance out of Portugal into international securities markets is legally possible and tax efficient, it is through the common representative that direct issuance out of Portugal, by an STC, has become marketable.

The concept of common representative of noteholders, whereby a given entity may be appointed to represent the holders of the notes of a given issue, has long existed under Portuguese law but, given its specific features, it has only been used in the domestic context and even then not broadly.

According to article 357 of the Portuguese Commercial Companies Code (PCCC) only law firms, chartered accountants and any individual could perform such a role.

And, although lawyers could be tempted to see this almost exclusive possibility as a potential market area, other entities, especially credit institutions, are better placed to perform investors' representation services.

It is therefore significant that article 65 of the Portuguese securitization legal regime now allows for the role of common representative of holders of securitization notes to be performed by not only the above mentioned entities but also by credit institutions and, most importantly, by any entity who is authorized to render professional investors' representation services within the EU.

Holders of asset-backed securities are investors that are familiar with a type of structure where their interests are represented by professional providers of investors' representation

services – typically trustees – so the fact that Portugal is a jurisdiction where the concept of trustee is not recognized and where, until the introduction of these changes to the securitization legal regime, no alternative concept could be used, the direct issuance of asset-backed securities by a Portuguese law governed entity and their direct placement near investors was just not commercially feasible (even if legally possible and tax efficient).

The terms and conditions of appointment of the common representative (that is, the identity and remuneration of the common representative) may be set out in the conditions of the securitization notes. However, the meeting of noteholders remains fully sovereign to remove the common representative that may have been so appointed, to appoint a new one and to amend the terms and conditions of the appointment.

Now that the holders of notes issued by an STC can be represented

by a common representative who can be an entity with whom investors may even be familiar (for example because such an entity, now wearing the hat of a Portuguese law common representative, has in the past performed, or usually performs, the role of trustee), it is possible to do without an intermediary SPV (who would be required to purchase the STC notes and issue notes to noteholders so they could be represented by a trustee).

The route to direct issuance out of Portugal is therefore open, but the existence of a widened concept of

common representative only benefits STCs. A common representative is a common representative of noteholders and not unitholders: the concept is not available to the holders of units issued by FTCs.

However, this does not mean that FTCs cannot issue directly out of Portugal into the

market. As already indicated, such issuance is legally possible and tax efficient and the safeguard of investors' interests by someone other than a trustee could in this case be entrusted to the fund manager in terms that could be extended from what has applied in the context of transactions concluded to date, where the trustee concept is in place at the SPV intermediary level.

- **Special rules on the certification of non-Portuguese tax residence**
Holders of securitization units issued by an FTC, or of securitization notes issued by an STC, benefit from a withholding tax exemption on any interest payments under such units or notes, provided they are non-Portuguese tax residents (the exemption failing to apply if the holder is a Portuguese tax resident, a resident in a black-list jurisdiction, or an entity who is more than 25% directly or indirectly held by a Portuguese or black list jurisdiction resident).

So the certification of this non-Portuguese tax resident status is crucial. A new regime has been put in place further to the introduction of these changes, provided the following conditions are met: (i) the securitization units or notes are registered or deposited with a non-Portuguese resident entity participating in an international clearing system established in an EU member state, in an OECD country or in a country with whom Portugal has entered into a double taxation treaty; and (ii) this non-Portuguese resident entity undertakes to the clearing system managing entity not to render registration or deposit services to Portuguese tax residents (or to non-Portuguese tax residents who do not benefit from the above-mentioned exemption).

When the above conditions are met, the non-Portuguese resident entity with whom the securitization units or notes are deposited confirms, to the clearing system managing entity, the non-Portuguese resident status of the holders of such units or notes and the relevant amounts for distributions and withholding. The clearing system managing entity will, in turn, give notice of such amounts to those required to withhold.

The ball's in your court

New asset types, new structures and new legal features have all contributed to make 2003 a landmark year for Portuguese securitization.

Looking forward, and building up on top of the progress made to date, the legislator has placed the ball in the market players' court in the sense that Portuguese law, from a substantive perspective and also from a procedural and tax point of view, is ready to take the challenges of a renewed market evolution, both in terms of asset classes and of structures allowing for direct issuance to be made out of the jurisdiction.

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