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Securitization in Portugal

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The long expected Portuguese securitization law (Decree-Law nr. 453/99), finally enacted on November 5, 1999, has created favourable conditions for significant growth in the Portuguese market. It simplifies the process, facilitates increased use of securitization and expands the classes of eligible assets to include mortgage loans — so far limited to consumer loans, car and equipment loans and leases and long-term rent.

Up to now these have been cumbersome, even impossible to securitize, due to the lengthy and expensive assignment and registration process.

In fact, even if securitization in Portugal may be said to have known a steady and consistent growth since July 1997 when the first securitization deal was completed (over the last one-and-a-half years the Portuguese securitization issuance volume has exceeded Eu1.5 billion ($1.5 billion), the absence of an appropriate and specific legal framework created the need to resort to traditional civil law concepts. This has required intricate, imaginative and elaborate legal structuring and tax planning.

Accordingly, the typical scenario has been that of tax-driven complex and expensive structures, requiring the intervention of a fairly comprehensive number of parties, and of the consequent rating and pricing related difficulties. Only as recently as May 1999 we were pleased to be involved in the first Portuguese triple-A securitization deal to be successfully completed.

The above mentioned securitization decree-law ("Securitization Law") establishing the adequate regulatory framework and a standard securitization structure is seen as:

(i) a crucial instrument in the simplification and expansion of the Portuguese securitization market and;

(ii) a clear sign of securitization's importance in the context of Portugal's capital markets and economy.

Key features of the new law

In very general terms, Decree-Law 453/99 may be said to have implemented the securitization regime in Portugal and regulated the incorporation and activity of the securitization vehicles.

The highlights of this new legal framework are as follows:

- Establishment of special rules facilitating assignments of credits in the context of a securitization;
- Listing of all potential originators/assignors;
- Definition of the type of credits that may be securitized;
- Creation of two different types of securitization vehicles:

(i) Credit Securitization Funds (Fundos de Titularização de Créditos – ("FTC") and (ii) Credit Securitization Companies (Sociedades de Titularização de Créditos – "STC")

Assignment of credits

Under the new law, whenever credits are assigned to one of the securitization vehicles they will be deemed to be assigned for securitization purposes, in which case such assignment, while at all times required to constitute a true sale (it may not be subject to condition or term), becomes the subject matter of specific regulation, deviating from the general rules on assignment of credits.

In fact, while the enforceability of an assignment of credits against the debtor continues generally to be subject to notification of said debtor, such notification (to be made by means of registered letter) is now deemed to have occurred on the third business day following registration of the relevant letter.

The most innovative feature in this respect is that of the waiver of the need to notify debtors when the assignor is a credit institution, a financial company, an insurance company, a pension fund or a pension fund managing company and the assignee is, as mentioned above, one of the securitization vehicles. In these cases, the assignment of credits is deemed to be effective towards the relevant debtors when effective between assignor and assignee.

Of very important notice is also the fact that the assignment of mortgage loans (for securitization 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 company secretary when the parties are corporate entities who have appointed one) amounting to sufficient title to register the assignment. Any such registration is now exempted from duties or fees.

This means that the former constraints on securitization of mortgage loans have ceased to exist. Accordingly and considering that Portugal is one of the fastest growing mortgage markets in the European Union (with an average annual growth of roughly 14% over the last few years) it is anticipated that mortgage-backed securitizations will soon be launched on a considerably large scale.

Finally, as far as assignment features are concerned, it should be noted that key securitization issues such as bankruptcy remoteness are adequately addressed in the new Securitization Law.

In fact:

- the proof of bad faith in the performance of certain acts which may be said to cause depletion of a given debtor's assets (which under certain circumstances is assumed as per the general terms of insolvency law) lies upon the creditor whenever such acts occur for securitization purposes;
- unless it is bad faith driven, no assignment of credits for securitization 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 its collection of payments in respect of credits assigned for securitization purposes shall not form part of the servicer's bankruptcy estate.

Who may assign credits for securitization purposes

Securitization is open to a wide range of entities:

- the state and any public corporate entities;
- credit institutions, financial companies, insurance companies, pension funds and pension funds managing companies;
- any other corporate entities whose accounts have been subject to legal certification for three consecutive years by an auditor registered with the Portuguese Securities Market Commission (Comissão do Mercado de Valores Mobiliários – "CMVM").

Which credits may be securitized

Most financial assets may be securitized, future receivables included when payments are quantifiable and foreseeable. But the receivables must meet the following requirements:

- their transfer may not be subject to legal or contractual limitations;
- they must be of a pecuniary nature and may 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 their respect.

Notwithstanding the above, an important limitation is set forth in respect of receivables to be securitized by insurance companies, pension funds and pensions fund managing companies. These entities may only assign, for securitization purposes, mortgage credits, credits against the state or other public corporate entities and pension funds' credits in respect of payments due by the relevant participants.

Securitization vehicles

A flexibility concern seems to have led to the establishment of two different types of securitization vehicles, the securitization funds and the securitization companies.

The reasoning behind the new Securitization Law is that this innovative, flexible regime only applies to the extent that receivables are securitized by resorting to the securitization vehicles.

Accordingly, it may have been felt that sticking to securitization funds only (thus following the Spanish model) could be too limiting, particularly when the national historical securitization background is SPV-based, a structure with which Anglo-Saxon investors seem to be more familiar. The two alternatives are an adequate means of attracting a wider and more diversified range of investors.

The Securitization Law regulates the incorporation and the activity of the two securitization vehicles and creates the required supervision mechanisms, as detailed below:

Alternative 1 - Credit securitization funds

The securitization fund, and the securitization units

Securitization funds are autonomous pools of assets:

(i) divided into units taking the form of registered securities ("Securitization Units");

(ii) held jointly by a different number of entities (individual or corporate) and;

(iii) presenting a variable or a fixed nature depending on whether credits may be acquired on a revolving basis and further units may be issued.

In no event may the securitization funds be liable for the debts of the above entities, for the debts of their managing companies, or of the entities from whom they acquired the credits forming part of such pools of assets. It should be noted that the credits acquired for securitization purposes must represent at least 75% of the securitization funds' assets.

The Securitization Units are registered securities granting their holders (who may not demand the liquidation of the fund) any or all of the following rights:

- payment of periodic income;
- reimbursement of the units' nominal value;
- sharing the remainder of the fund, in proportion to the relevant participation, upon the fund's liquidation.

When the management regulation so allows, there may be different categories of Securitization Units (that is, sets of units that grant their holders identical rights but, when compared with other sets of units, entail a different ranking insofar as the exercise of the above rights is concerned).

Accordingly, although under a concept similar to that of regular investment funds, securitization funds are structures fully dedicated to the performance of the payments under the Securitization Units on terms close to those found in SPV-based structures.

The managing company

The securitization funds are managed by managing companies (Sociedade Gestora), i.e. financial companies that are required to:

(i) hold registered offices and effective management in Portugal; (ii) qualify as a sociedade anónima (public limited liability company) whose share capital is represented by nominative or registered bearer shares;

(ii) be exclusively engaged in the management of one or more funds on behalf of the holders of Securitization Units and;

(iv) include in its name the expression SGFTC.

These managing companies may, pursuant to the terms of the corresponding management regulations and in accordance with any conditions and limits that may be established by the CMVM, enter into loan and swap agreements on behalf of the funds they manage. This is something that (along with other expressly listed activities) they are prevented from doing if in their own name or for their own account.

Of relevant notice is also the fact that managing companies are subject to ownership restrictions. The seller of receivables may not, directly or indirectly, own more that 20% of the relevant managing company's share capital when it has assigned more than 20% of the net value of all funds managed by said managing company. They are also subject to specific capital adequacy requirements. The managing company equity must correspond to a minimum percentage of the net value of all funds managed: up to Eu75 million (1%), in excess of Eu75 million (0.1%).

The depository

The securitization fund's assets are required to be held by a depository on behalf of the fund. The depository must qualify as a credit institution with equity in excess of Esc1.5 billion ($7.5 million) and is required to hold registered offices in Portugal or in another European Union member-states, in which case it must have a branch in Portugal.

A written contract to regulate the relations between managing company and depository will be required.

Alternative 2 - Credit securitization companies

The securitization company

Securitization companies are financial companies required to:

(i) qualify as a sociedade anónima (public limited liability company) whose share capital is represented by nominative or registered bearer shares;

(ii) include in its name the expression STC and;

(iii) be exclusively engaged in the carrying out of securitization transactions by means of acquiring, managing and transferring receivables and of issuing notes as a source of financing such acquisitions — even if they are entitled to

provide additional securitization-related services.

It must be noted that, save in specific circumstances set out in the law, securitization companies may only transfer receivables to securitization funds or other securitization companies.

The securitization companies' activity may only be financed with equity or through the issuance of notes in conformity with the Securitization Law requirements, it being expressly forbidden for securitization companies to issue obrigações de caixa (a type of debt instrument that is only available to other financial entities and that benefits from a specific regime in respect of limitations and formalities) or to acquire the notes they have issued.

Securitization secured notes

Without prejudice to what was said in respect of the issuance of obrigações de caixa, the securitization companies may issue any kind of notes, secured notes included.

Under Portuguese law these are a newly established type of note only capable of being issued by securitization companies. Their main feature is that their reimbursement is guaranteed by credits exclusively allocated to them — they are of limited recourse to the specific assets backing them.

This segregation principle is made effective by the legal provisions which impose the need for said credits (those allocated to a secured note) to be identified as such (in a codified form, the corresponding key being deposited with CMVM) and to be treated as an autonomous pool of assets that is not available to satisfy any other debts the securitization company may have.

The holders of secured notes are further entitled to an additional creditor's privilege. Their rights rank senior to those of the other creditors in respect of credits allocated to the relevant issue of notes.

Again, for flexibility purposes, there are relevant deviations from the general rules on the issuance of notes for securitization purposes, as follows:

- no submission to registration with the competent Commercial Registry Office even if registration with the CMVM is required in certain circumstances;
- no issuance amount limits in respect of securitization secured notes rated A or above.

Supervision mechanisms

The Bank of Portugal and the CMVM are the regulatory and supervision authorities insofar as securitization in Portugal is concerned.

The role these entities play may be summarized as follows:

- The creation of securitization funds is subject to the prior authorization of CMVM (the authorization request being required to be filed with, inter alia, the draft management regulation) 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 managing company, said authorization 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 securitization funds activity;
- The incorporation of securitization companies and funds' managing companies is subject to the authorization of the Bank of Portugal which is also the entity in charge of their supervision, as in the case of any other financial company;
- The issuance of notes by securitization companies is in most cases subject to registration with the CMVM, who may further regulate the registration conditions.

Tax Issues

The most common criticism in respect of the Securitization Law is the absence of a specific fiscal framework, something that in practical terms may continue to impose the need to resort to the tax-driven complex structures we have made reference to.

The main issues on which clarification is required are those related to the submission of the assignment of credits to stamp duty taxation and to how the regulatory authorities will be dealing with withholding tax matters (currently imposed on interest payments at the rate of 20%).

There are informal indications that the tax authorities will be amenable to the position whereby stamp duty will be imposed on assignment of credits for securitization purposes (and also legal grounds to defend such a position, when no new financing element may be found in the relevant transaction) and that national and foreign investors will be treated differently for withholding tax purposes in the sense that interest payments to the latter will only be subject to withholding tax when said investors are not subject to taxation in their home jurisdictions.

All of the above, as well as other regulatory issues, such as the minimum share capital securitization companies and securitization fund managing companies will be required to have, is expected to be clarified soon.

Securitization appears as a precious tool, enhancing diversification of the financing sources at lower cost and mitigated risk and contributing to an increasingly high degree of financial sophistication

Conclusion

The establishment of a securitization standard structure, in the context of which mortgage loans are capable of being securitized and the most relevant securitization issues are adequately addressed, will definitely enhance the Portuguese securitization market.

In a growing and competitive economic environment sustained by consumption and credit granting expansion and where the deposits have long ceased to be the financial sector's source of funding, securitization appears as a precious tool, enhancing diversification of the financing sources at lower cost and mitigated risk and contributing to an increasingly high degree of financial sophistication.

In short, this new law certainly offers a very relevant contribution to make available to the Portuguese banking sector an effective solvency ratio instrument as it allows an adequate balance sheet management policy to be implemented. In addition, and not for the benefit of banking sector entities only, securitization may now be seen as a low cost source of liquidity and funding.

For all that has been said it is only natural that investors and rating agencies are looking at Portugal as a new securitization market with an immense growth potential in 2000. ■

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