

New Treatment for Exposure

Vieira de Almeida advises on the new legal treatment for positions in Portuguese securitizations

By Paula Gomes Freire

WHILE THE MARKET continues to await a revised securitization law, legislation has been enacted in Portugal (Decree Law 103/2007 and Decree Law 104/2007, both dated April 3, 2007) to implement Directives 2006/48/CE and 2006/49/CE of the European Parliament and of the Council. These directives are the European Union's legal response to the outcome of the Basel Committee on Banking Supervision's work to ensure convergence on the revision of supervisory regulations governing the capital adequacy of internationally active banks. This means that both the prudential regulation of banking activity in Portugal, generally, and the prudential treatment of securitization transactions, in particular, are now more closely aligned with Basel II recommendations.

Highlights of these recommendations for securitization include: (i) significant transfer of credit risk, related to securitization exposures, to third parties; (ii) no ability of originators to retain ownership of the receivables that are transferred to securitization vehicles; (iii) consistent bankruptcy remoteness through legal ring-fencing of the assets, so that securitization exposures cannot be reached by the originating bank or its creditors, even in an insolvency scenario; (iv) no effective control by the originator over transferred exposures, namely by denying the right to repurchase such exposures; and (v) requirement that an opinion by qualified legal counsels is delivered to confirm the verification of the above points in the relevant transactions. These recommendations have indeed been reflected in national legislation and regulations.

In fact, in the aftermath of the aforementioned legislation, a new set of Bank of Portugal regulations was also published to further regulate the applicable legal provisions. Insofar as the prudential treatment of securitization transactions is concerned, it is relevant to consider Bank of Portugal's regulation nr. 7/2007 of April 18, 2007. This regulation sets forth new capitalization requirements for the positions undertaken by credit institutions and investment companies in the context of securitization transactions, which, as of January 1, 2008, are applicable to all such institutions and companies.

According to the Regulation (*Aviso*) at stake and a set of Instructions (*Instruções*) and Notices (*Cartas Circulares*) complementing it, the requirements applying in respect of the positions undertaken in the context of securitization transactions are dependent upon the approach taken by the relevant originator for calculation of its own funds for credit and collection risk. That is: (i) the standardized approach or (ii) the internal ratings-based approach.

Upon assessment of the applicable approach, the crucial factor for determining the relevant funds requirements in the context of these transactions is transfer of risk. Significant transfer of risk inherent to the assets at stake in the context of the relevant transaction continues to be the key element to assess the relevant capital treatment that may apply.

This significant transfer of risk can only be deemed to exist in those transactions where - besides the conditions that already applied under previous regulations - certain new and more demanding conditions are met. These include: (i) no significant involvement of the originator in securitization transactions (the global volume outstanding in respect to the assigned risk positions shall not exceed 20% of the consolidated assets of the originator, accrued of all positions already assigned in the context of securitization) and (ii) no implicit support by the originator to the transaction at stake. Implicit support is deemed to exist when the transaction encompasses financial support mechanisms that exceed the initially contracted obligations, such as the sale of risk positions below market value.

In a nutshell, we are facing a new prudential framework for securitization transactions, one that is more demanding and in line with capitalization requirements based on the material risks to which credit institutions are exposed. Indeed, Basel II is proving to be the new philosophy for banking activity regulation.

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About the Firm:

Vieira de Almeida & Associados (VdA) is a major independent organization that has asserted itself as one of the largest and most highly reputable law firms in Portugal. With offices in Lisbon, Madeira and Oporto, VdA has strong, longstanding relationships with law firms throughout the world and oversees a strong securitization practice, having advised on 13 of the 14 securitization transactions completed in Portugal between January 2007 and April 2008.

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