Case: how the Basle II Principles are accommodated in the Portuguese securitisation legal framework

By Paula Gomes Freire and Tiago Correia Moreira, Vieira de Almeida & Associados, Sociedade de Advogados, R.L.

Incorporated towards the end of 1974, the Basle Committee on Banking Supervision was originally created by the directors of the central banks of a group of 10 countries. The first meeting took place on February 1975 and from then onwards, members have been gathering, on a regular basis, such organisation now relying on the input of its 55 members, including Portugal.

Although its recommendations are 'soft law', the role of the Basle Committee has not been ignored worldwide and its voice has been heard all over the world. Focusing on the need for the strengthening of the international banking system, the Committee engaged in the revision of the Basle I Agreement by proposing the new Basle II Agreement. This agreement introduces new and reinforced practices for controlling the risk of the banking system, providing for a variety of options which allows banks and supervisory entities to choose the most appropriate methods to comply with the minimum capital requirements, as well as to deal with the credit and operational risks in accordance with their own type of transactions and market segments.

The New Basle II Agreement is composed of three pillars – (I) minimum capital requirements, (II) supervisory review process and (III) market discipline – being within the first pillar that the Committee provides and sets out the securitisation framework which will, in the end, be put into practice (via the enactment of EU legislation) under the Portuguese legal framework.

In fact, it has been curious to observe how such a general framework as the one proposed by the Basle Committee, eventually becomes the source of inspiration of specific rules to be complied with by market players and their advisors throughout the world. Basle II has, in accordance, built the grounds for the enactment of the Directives 2006/48/CE and 2006/49/CE of the European Parliament and of the Council. These directives are the EU legal response to the outcome of the Basel Committee on Banking Supervision's work over recent years to ensure convergence on the revision of the supervisory regulations governing the capital adequacy of internationally active banks.

Specifically in relation to the Portuguese context, while the new securitisation law continues to be awaited, legislation has been enacted (Decree-Law 103/2007 and Decree Law 104/2007, both dated April 3, 2007) to implement, in Portugal, Directives 2006/48/CE and 2006/49/CE of the European Parliament and of the Council.

This means that both the prudential regulation of the banking activity in Portugal, generally, and the prudential treatment of securitisation transactions, in particular, are now more closely aligned with Basel II recommendations.

Highlights of these recommendations for securitisation include:

- significant transfer of credit risk, relating to the securitisation exposures, to third parties;
- no ability of originators to retain the ownership of the receivables that are transferred to the securitisation vehicles;
- consistent bankruptcy remoteness entailing legal ring-fencing of the assets, so that the securitisation exposures cannot be reached by the originating bank or its creditors, even in an insolvency scenario;
- no effective control by the originator over the transferred exposures, namely by denying the right to repurchase such exposures or to cover the risk thereof; and
- 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 above mentioned 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 securitisation 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 capitalisation requirements for the positions undertaken by credit institutions and investment companies in the context of securitisation 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 own funds requirements applying in respect of the positions undertaken in the context of securitisation transactions are in first instance dependent upon the approach taken by the relevant originator for calculation of its own funds for credit and collection risk, i.e.:

- the standardised approach; or
- the internal ratings based approach.

Upon assessment of the applicable approach, the crucial factor for determining the relevant own funds requirements in the context of these transactions is transfer of risk. Significant transfer of the risk inherent to the assets at stake in the context of the relevant transaction ('true sale') 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, such as:

- no significant involvement of the originator in securitisation transactions (the global volume outstanding in respect of 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 securitisation); and
- 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 for example the sale of risk positions below market value).

Overall, this is thinking big and acting small – by paying close attention to the Basle II thoughts and recommendations, one comes in the end to enact the legal provisions which put them into practice.

This article was written by Paula Gomes Freire and Tiago Correia Moreira, Viera de Almeida & Associados, Sociedade de Advogados, R.L. Av. Duarte Pacheco, no. 26, 1070-110 Lisbon, Portugal.
Tel: +351 213 113 479, +351 213 113 447, Fax: +351 213 522 239, Email: pgf@vda.pt, tcm@vda.pt, Web: www.vda.pt