PORTUGAL

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This article provides a brief overview of the main aspects of Portuguese securitisation regulations, addressing, in particular, the credits assigned for securitisation purposes, the two vehicles that may execute securitisation operations under the new legal regime and the tax implications of such operations.

Introduction

It was only recently that Portugal introduced, through Decree-Law 453/99 of November 13, 1999, a legal regime for securitisation. This new regime essentially follows the legislative trend in securitisations in Southern Europe. Securitisation may be used as a form of relieving the weight of credit risks on companies' balance sheets, especially for credit institutions. Decree-Law 453/99 envisages the regulation of both the assignment of credits for securitisation purposes and the incorporation and activity of the securitisation vehicles i.e. securitisation funds and securitisation companies.

Until now, the usual procedure for carrying out securitisation operations in Portugal was to incorporate an SPV which would then issue securitised notes to be sold to institutional investors. The new regulation creates broader perspectives since it is now possible to address securitised bonds or securitised units to non-institutional investors.

Nevertheless, Decree-Law 453/99 only establishes the regulation of traditional securitisation schemes (e.g. pass through securities or collateralised securities), but does not provide rules applicable to more recent securitisation models, such as those that do not demand the transfer of the securitised credits from the originator to the securitisation vehicle.

Moreover, the new regime establishes some restrictions concerning both the type of credits that may be assigned for securitisation purposes and the entities that may be involved in the securitisation operations (see figure 1).

Considering the Portuguese economic outlook, it is expected that securitisation operations will focus on the creation of securities (bonds or participation units) backed by credit rights emerging from bank loans (including mortgages), personal credit and trading receivables, among others.

Securitised credits and guarantees

Regarding the credits that may be purchased for securitisation purposes, the law requires that the credits (present pecuniary credits or future pecuniary credits arising from existing legal relations, whose value is known or can be estimated) must be free of any legal or contractual restrictions or conditions on their transfer, may not have been given in guarantee, detained or seized, and may not yet be mature.

On the guarantee of the credits, Decree-Law 453/99 allows the credits to be guaranteed by entities other than the assignor and from any other entity that is in a group or domain relation with the assignor, namely allowing the risk of credit default to be transferred to an insurance company.

In order to enhance the use of securitisation, the legislator reduced the formal requirements on the assignment of credits for securitisation purposes. Examples of this intent are shown in the waiver of the requirement of notification to the debtors of the assigned credits in several situations, namely when the assignor is a financial institution, an insurance company, a pension fund or a pension fund management company, and in abolition of the requirement of a public deed to assign mortgage credits.

In fact, the regime of Decree-Law 453/99 provides some special rules for the securitisation of credits held by financial institutions, as confirmed by the lessening of formal requirements and the required relationship that such entities must maintain with the debtors after the transfer of the credits to a securitisation fund or a securitisation company.

Thus, whenever the assignor is a credit institution, a financial company or an insurance company, it is mandatory that the assignor maintain the management of the assigned credits and provide the collection and administrative services related with the credits and the debtors, by entering into a management of credits agreement with the assignee (the securitisation fund or the securitisation company).

In other situations, the credit manager functions may be performed by a third party or

the assignee. The credit manager assumes an important role in the securitisation process since it is the liaison with the debtors for the collateralised credits during the life of such credits. The legislator even granted a special power to the credits manager, which is the requirement of its express and individual approval for the charge or transfer of securitised credits, except if the manager is the assignee.

Although Decree-Law 453/99 establishes a favourable system for the development of securitisation operations there are also limitations, mainly regarding the entities involved. On the one hand, the purchase of credits for securitisation purposes under this system is only allowed by securitisation companies or securitisation funds. On the other, the assignment of the credits is authorised only for the following entities:

- the Portuguese State or other Portuguese State entities;
- credit institutions;
- financial companies;
- insurance companies;
- retirement funds;
- retirement fund management companies;
- other companies or entities which have their accounts legally certified by an auditor registered with the Portuguese Securities Market Commission (*Comissão do Mercado de Valores Mobiliários*); and
- foreign companies or entities which have their accounts certified by an internationally recognised auditor, as long as the investors' interests are duly protected and the company's situation adequately analysed.

Securitisation funds

Creating a securitisation fund is one of the possible ways to securitise credits under the framework of Decree-Law 453/99.

For a securitisation fund to carry out securitisation operations in Portugal, the managing company must have its headquarters in Portugal. Consequently, the fund itself will be considered to be located in Portugal.

Securitisation units may give their holders the right to periodic payments/returns, the reimbursement of the units' nominal value and/or a proportional part of the remaining value of the securitisation fund by the time of its liquidation and division.

As with securities, securitisation units may be issued through public offers and may be listed on the Lisbon and Oporto Stock Exchanges.

Securitisation funds are separate funds (i.e. 'autonomous patrimonies') whose property is attributed to the holders of the securitisation units. The funds may be of either variable or fixed patrimony depending on whether their assets or liabilities may be altered, but their patrimonies must be composed of a minimum of 75% of credits for securitisation.

The incorporation of the fund is subject to prior authorisation from the Portuguese Securities Market Commission, which must be requested by the fund management company.

The favourable opinion of the Bank of Portugal or the Insurance Institute of Portugal may also be necessary if the assignor is a financial institution (pension funds and their management companies included) or an insurance company, respectively.

Securitisation fund management companies are considered financial companies, whose exclusive purpose is the management of one or more securitisation funds. These management companies may not assign the powers of administration of the securitisation fund to third parties, notwithstanding the possibility of using third parties to provide necessary services.

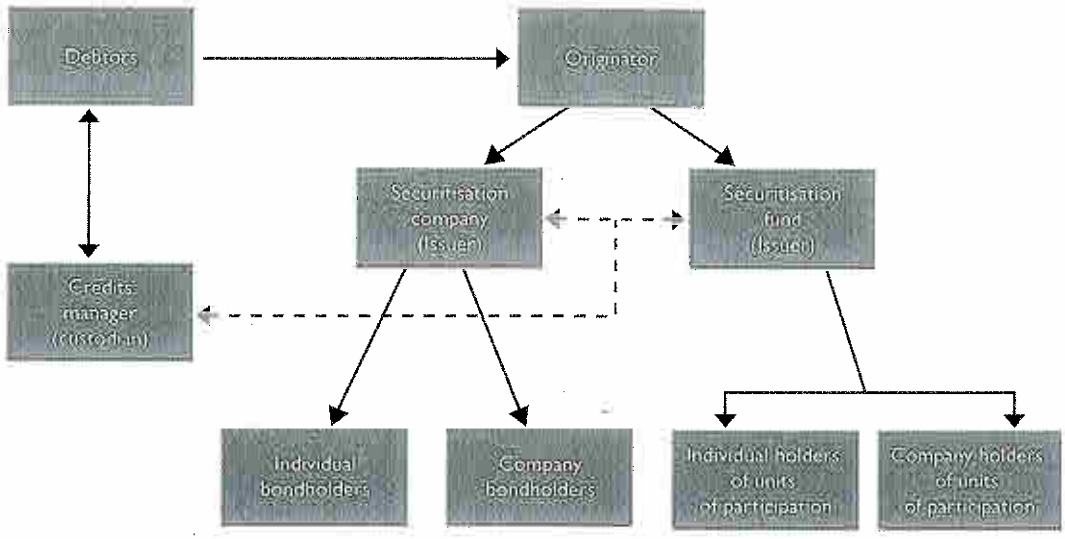
In the course of business, securitisation fund management companies are prohibited from:

- obtaining loans for their activity or providing credit to other entities;
- creating charges;
- encumbrances or any liens over the credits of the fund;
- purchasing for themselves any Portuguese or foreign securities of private entities; and
- purchasing real estate properties, other than those necessary for their facilities.

Securitisation fund management companies must have a minimum share capital of €750,000 and must own assets in a minimum percentage equivalent to 1% of the net value of the managed funds when such value is not greater than €75m, and equivalent to 0.1 % for a net value greater than €75m.

There are two major legal requirements which a securitisation fund management company must comply with: on the one hand, the company must have its head office and effective administration located in Portugal; on the other hand, an assignor is not allowed to have a direct or indirect interest in the securitisation fund management company share capital, of more than 20%, following the transfer by the assignor of more than 20% of the total net value of the securitisation funds, or of each fund managed by such company.

Securitisation funds and their management companies are respectively subject to the regulatory supervision of the Portuguese Securities Market Commission and of the Bank of Portugal.



Securitisation companies

Similar to the fund management companies, securitisation companies are deemed financial companies.

The sole purpose of securitisation companies is the execution of securitisation operations through the purchase, management and transfer of credit pools, as well as the issuance of securitised bonds to fulfil the payment of the purchased credit pools.

In addition, securitisation companies can also render services to credit assignee entities concerned with the study of the credits' risks and the credits' management.

The activity of these companies can only be financed with their own capital resources (the minimum share capital is of €2.5m) and the issuance of bonds. However, the acquisition of their own bonds and the issuance of short-term bonds is prohibited.

As with any other company, a securitisation company can issue bonds within the limits set forth in the Portuguese Companies Code. However, securitised bonds issued in accordance with Decree-Law 453/99 were given a special regime and therefore are not subject to such limits as long as they have an 'A' rating or equivalent.

Nevertheless, as well as securitisation fund management companies, securitisation companies are also subject to prudential ratios.

In accordance with a recent rule (*Aviso*) issued by the Portuguese Central Bank (*Banco de Portugal*), securitisation companies must comply with the following prudential ratios: The company's own assets cannot be inferior to:

a) 5% of the total amount of the issued securitised bonds, provided the company has formally issued securitisation bonds with private placement and with a minimum value of Esc100m;
b) 10% of the total amount of the issued securitisation bonds in all other cases; and,
c) 10% of the total amount of the issued securitised bonds, if the company has issued securitised bond with a nominal value inferior to Esc100m.

Pursuant to Decree-Law 453/99, securitised bonds are bonds whose reimbursement is guaranteed by collateralised credits. In each issue of securitised bonds, it is necessary to identify the characteristics of the collateralised credits in the issuance documentation (e.g. the public offer prospectus) through a code that may only be revealed pursuant to a request by the holders, representing a minimum of 10% of securitised bonds of the issuance, if there is breach of the bond loan or of any of the interest or capital instalments.

Each pool of collateralised credits is separated as an autonomous patrimony that cannot be executed for other debts of the securitisation company. Furthermore, the holder of the securitised bonds is given a special creditor privilege over the collateralised credits, without the need to register such privilege.

Securitisation companies can execute the necessary exchange operations and derivative agreements for the coverage of risks inherent to their activity. Furthermore, these companies can additionally purchase rated securities or short-term treasury or company bonds.

Tax regime

The traditional approach

The old-fashioned form of securitisation was not

subject to a specific tax regime. Therefore, the tax burden was often significant unless a careful plan was structured or those operations benefited from the specific exemptions.

The tax burden might be substantial because both the SPV and the investors were subject to taxes without a neutral tax framework. The SPV was subject to corporate income tax on all income realised in Portugal or abroad. Loans could attract stamp duties. Finally investors might again be subject to income tax on interest received.

Investors tried to obtain neutrality by structuring their operations in such a way that interest was deducted from the SPV taxable income, in order to limit taxation to the bondholder level.

However, at a certain stage the International Centre of Madeira with its special tax regimes attracted several securitisation operations. Provided certain conditions were met, both the SPV and the investors could be exempted from income taxes and also stamp duties were not imposed. For the time being this route can still be used, but special care should be taken in view of the different existing regimes and, in particular, in relation to the special instructions dictated by the EC Commission to the Portuguese Republic in terms of compliance with the EC State Aid regime.

The new tax regime

The tax regime for both securitisation funds and companies is not yet defined (June 2000). However, a general authorisation has already been granted to the Government by the Parliament in order to create a tax neutral regime.

In accordance with the relevant Budget Law provision, the Government is authorised to establish the tax regime of securitisation operations, to be performed under the terms and conditions of Decree Law 453/99, as one of tax neutrality. In other words the total tax burden of the securitisation vehicle and the investor, should not be greater than that which a direct investment would attract [Budget Law n° 3-B/2000 of April 4, 2000, article 69° n° 4 a)].

At the current time it is difficult to predict what the final result will be in terms of taxation. Although several methods are conceivable, it is possible that the present tax regime of resident investment funds may be adopted, at least at the securitisation funds level, and more precisely absorbing the tax regime of the marketable security funds (FIM).

According to this existing regime, taxation of the fund itself should be differentiated from taxation of participation units and, furthermore, taxation of individual taxpayers (apart from those which acquire such participations within their commercial activity) and companies is treated differently.

Thus, at a first stage, funds may become subject to tax autonomously. Securitisation funds may eventually be subject to tax directly at a tax rate of 20% or 25% which would be a final tax provided the holders of the units of participation are not corporate taxpayers or individual entrepreneurs.

If this is so, distributions by the fund to a corporate taxpayer (holder of an unit of participation) may constitute taxable income of the latter and the tax paid by the fund may then be treated as a payment on account of the taxpayer's corporate tax liability.

The company managing the fund may be obliged to publish the amount distributed and the amount of tax paid periodically.

Also, in the case that this regime is followed, distributions by the fund to a non-resident company without a permanent establishment may be tax-exempt.

It is difficult to predict if capital gains realised by a fund will be taxed at a flat rate of 10% on net capital gains or at a higher rate. VAT and stamp duties should also be considered in structuring these investments, in order to verify whether these operations may be exempted or not.

It is unlikely that the same type of regime would be adopted for securitisation companies. The different type of structure of each vehicle also creates the need to establish an appropriate tax regime to regulate the relationship between the company that manages the funds and the funds themselves, between the former and its shareholders and the latter and the holders of units of participation. The tax regime between the securitisation company and its shareholders, or the holders of the securitised credits, will certainly be subject to a different tax treatment.

To predict which regime will apply to securitisation companies is still more difficult – obliging one to enter into the realm of *Nostradamus*. The simplest regime to be established may determine that companies and bondholders are taxed as the current companies and bondholders are i.e. companies are subject to a general tax rate (32%) but may deduct interest paid to third parties (bondholders) and bondholders pay income tax on the interest received (e.g. 20% for individuals and 32% for companies). In such case, non-resident investors may benefit from the advantage of reduced withholding tax rates in accordance with the treaties.

The legislator's obligation is to introduce a tax regime where the investor (or originator) incurs neither incremented tax costs nor a tax-timing disadvantage as a result of entering into this

particular transaction. Thus, at the end of the day, the tax cost ultimately will be borne by the investor.

As can be seen these possible scenarios are not homogeneous in terms of calculating taxable income tax rates and the timing of taxation. With this in mind, it may be that resident institutional investors would be more attracted by channelling their investments via the securitisation fund while non-resident investors may consider that securitisation companies are more advantageous because interest would reduce taxable income and could be subject to lower withholding tax rates provided a treaty applies. This will depend on the tax regime established by the State of Residence.

However, incentives and anti-avoidance measures can also be introduced in order to approximate the tax burden between both securitisation vehicles and their investors.

It must be hoped that the principle of neutrality is respected and that there will be no discrimination between the two investment routes i.e. via securitisation funds or securitisation companies.

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