26

The new Belgian legislative framework for securitisations at work

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Despite the international sub-prime crisis and general negative sentiment in the securitisation markets, affecting not only commercial mortgage-backed securities, but also other types of asset transaction, the Belgian securitisation market continued to see activity generally in line with that of 2006 through to the end of 2007.

At the same time, parties have become more acquainted with the new legislative framework following the Undertakings for Collective Investment in Transferable Securities (UCITS) Act (July 20 2004), which implemented the EU UCITS Directive, and the Prospectus Act (June 16 2006), which implemented the EU Prospectus Directive and amended the former prospectus legislation. Public securitisation structures remain unattended, whilst institutional or private structures are considered to combine the proverbial best of both worlds, so that the institutional aspects of deals do not jeopardise the liquidity of the notes. The market has seen the emergence of new originators (eg, Delta Lloyd and Axa Bank Belgium), while traditionally active players (eg, Fortis, Dexia, KBC and ING) have continued to produce a (smaller) number of deals, in particular in view of achieving on-balance funding. It remains to be seen whether and to what extent, deal flow may decrease in line with international trends, or increase if systemic confidence sets in again later this year.

Regulatory framework at work

As set out in further detail in the Laga chapters of *Global Securitisation and Structured Finance 2006* and *2007*, the securitisation of debt receivables in Belgium often involves a company for investment in receivables (*société d'investissement en créances* (SIC)) as the purchasing and issuing special

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purpose vehicle. One of the major benefits of using a SIC is that its use should not create any material tax burdens (in terms of stamp duty, corporation tax, withholding tax and value added tax). The traditional distinction is between a SIC which offers securities to the general public (a public SIC) and a SIC which offers securities only to specific categories of institutional or professional investor (an institutional SIC): while a public SIC is subject to the regulatory supervision of the Belgian Banking, Finance and Insurance Commission and its establishment needs the commission's approval, its institutional counterpart is subject only to minimum regulation.

There is no regulatory requirement obliging Belgian originators to use a Belgian SIC. For trade receivables and other non-regulated assets such as corporate loans and commercial mortgages, offshore vehicles can be and are frequently used (such a choice being typically determined by the tax analysis). However, securitisation of regulated receivables is only feasible by using a SIC since:

- for mortgage receivables, the assignment to a SIC does not need to be recorded in the land register to be effective and therefore benefits from an exemption from the relatively high stamp and mortgage duties on the secured amount and other costs; and
- for consumer credit receivables, the transfer is statutorily only allowed for a limited number of institutions, including SICs.

UCITS Act

The UCITS Act entered into full effect at the end of 2005 following a transitional period. It significantly enhanced SICs' bankruptcy remoteness by statutorily confirming the ring-fencing of its other compartments in case of insolvency of one compartment. In addition, it confirmed that non-petition clauses are effective. Finally, special legislation was introduced allowing a SIC to appoint one or more representatives of the note holders to perform a role broadly similar to a typical English trustee within a Belgian legal context.

The UCITS Act introduced important changes with respect to the management of public SICs. The main new requirement is that each public SIC must either be set up to manage itself autonomously or appoint a management company that is licensed by the commission to manage public SICs. For standard securitisation transactions, autonomous" management is not feasible since a SIC is a special purpose company without staff. Therefore, the only realistic option is to operate through a licensed management company. Since the UCITS Act came into force, Belgium has not witnessed any structure that involves a new-style public vehicle.

In order to obtain a licence as a management company, a company must have a management, administrative and technical structure that the commission considers appropriate for managing the assets of a SIC. Under certain conditions a management company may outsource one or more of its tasks (one of the conditions being that the sub-manager is also under the prudential supervision of the commission, has an appropriate organisation and is established in Belgium). The servicing of public SIC assets is also deemed to constitute a management task and therefore is in principle subject to the same outsourcing requirements. However, in the event that the originator is appointed as servicer, the outsourcing requirements are inapplicable.

Aside from the new rules on management, a public SIC will continue to be subject to the existing regulatory requirements of control and supervision, notably for each public issue, the publication of an offering circular approved by the BFIC (and reporting thereafter on an annual, semi-annual and quarterly basis), and the appointment of:

- a statutory auditor;
- a custodian (typically a Belgian credit institution) responsible for the safekeeping of cash balances and securities;
- a supervision company (who monitors the sale and repayment of the securities issued by the SIC and the evolution of the cash flows and the risk

profile of the portfolio of receivables in accordance with the financial plan);
- a security agent (who acts at the appointment and in the interest of the noteholders); and
- one or more rating agencies.

The UCITS Act introduced few changes for institutional SICs. Emphasis is put on the SIC's obligation to manage its assets on the basis of the principle of risk diversification and in the exclusive interest of the investors. Therefore, it may be asked whether an institutional SIC is still able to set up a single asset transaction.

As a condition for qualifying as an institutional SIC, the SIC must at all times obtain its entire funding (both equity and debt) from a limitative list of institutional or professional investors. The only applicable exception introduced by the UCITS Act relates to cases where a non-institutional originator provides funds as actual credit enhancement (ie, funds provided to the SIC to protect the investors against the default risks related to the receivables). Between May and September 2006, prior to the implemententation of the relevant provisions of the UCITS Act, the commission used its ruling power to approve a similar derogation from the obligation to obtain funding exclusively from institutional investors, with regards to funding provided as credit enhancement.

An institutional SIC must be duly registered with the Federal Ministry of Finance prior to commencing its activities. However, this does not include any active upfront control or continuous monitoring and hence (unlike the commission for a public SIC) there is still no official rubber stamp that the criteria for an institutional SIC have been met.

Prospectus Act

Notable disadvantages of an institutional SIC left unresolved by the UCITS Law were that:

- the list of institutional or professional investors remained quite limited and certain categories referred to therein remained subject to interpretation difficulties;
- regardless of the structural arrangements ensuring that investors are at all times solely institutional, that institutional character could be at risk (with significant adverse tax consequences) if certain securities at any time happened to be sold to non-institutional parties; and
- the securities issued by a SIC are not liquid since they may not be listed on a regulated exchange in Belgium, or arguably even abroad.

At the start of 2006 the government decided to address these issues as part of the act implementing the EU Prospectus Directive (2003/71/EC), which was adopted by Parliament on June 16 2006 and applied on July 1 2006. There are two key changes.

First, the principle remains that an SIC is considered to be institutional if and when it attracts its funding solely from institutional investors. The existing list of institutional investors remains in place generally speaking, including:

- credit institutions registered in Belgium; Belgian and foreign regulated investment companies conducting activities in Belgium;
- collective investment institutions and their management companies; and
- other foreign institutions and companies considered as professional or institutional investors under their national laws or in accordance with local financial market practices (which may now include a wide range of entities or even individuals which are considered in the local market to be qualified investors under the EU Prospectus Directive);

In addition, the list of qualifying entities has been expanded to include:

- Belgian or foreign entities whose sole corporate purpose is investing in financial instruments issued by collective investment institutions; and

- Belgian or foreign entities whose main activity is investment in securities issued by collective investment institutions or in securitisation structures, provided that they attract their financing solely from institutional parties referred to in the new list if in Belgium, and/or from any investors without limitation if abroad. In other words, the interpretation difficulty as to whether such (often conduit) entities act on their behalf or on behalf of their underlying investors should now be resolved in that they are considered to act in their own name and on their own behalf, albeit that underlying Belgian investors should qualify as institutional parties.

The concept of an institutional investor was further expanded by a royal decree of September 26 2006 (which came into force on October 6 2006) to include some entities which do not meet the criteria but which expressly apply for the status of institutional investor. If the conditions of the royal decree are met, such entities are registered in the list of institutional investors kept by the commission and published on its website.

Second, since the implementation of the Prospectus Act, if securities issued by a SIC are admitted to trading on an organised market accessible to the public or third parties at any time trade such securities to entities that do not qualify as institutional investors, such a course of action will no longer jeopardise the institutional character of the SIC provided that:

- at the time of structuring the transaction, the SIC has taken all appropriate measures to guarantee that the securities fall in the hands of non-institutional investors; and
- throughout the term of the transaction, the SIC itself (and any entities acting on its behalf) would not act (or omit to act) in such a way that it contributed to or increased the risk that its securities would be sold to non-institutional investors.

A royal decree of September 15 2006 set out the criteria to be met in order to fulfil the requirement that all appropriate measures are duly taken. The following conditions must be cumulatively met (without prejudice to the possibility provided in the UCITS Act to attract funding from the non-institutional originator as actual credit enhancement):

- The terms and conditions of the securities issued by the SIC, its articles of association and management regulations and any other document relating to the issuance, the subscription or the trading of such securities must explicitly provide that the securities may only be subscribed, acquired or held by institutional investors;
- The bearer securities, or in case of registered securities the register of such securities and the certificates confirming the inscription in that register, must indicate that the securities may only be subscribed, acquired or held by institutional investors;
- The listing prospectus should confirm the same;
- Any communication made by the SIC in any form should confirm the same;
- The securities should be in registered form, and/or the subscription value of a single note (or other security) issued by the SIC should be at least €250,000, and/or each investor subscribing to or acquiring any such security should confirm formally in writing to the SIC that it qualifies as an institutional investor within the meaning of the Prospectus Act and that it undertakes not to transfer its security(ies) issued by the SIC to an entity other than one that has also made this double confirmation to the SIC;
- The SIC shall refrain from paying any dividends or interest relating to these securities discovered not to be held by an institutional investor;
- With regard to registered securities, the SIC shall refuse to inscribe an investor in the relevant security registry if it discovers that such an investor does not qualify as institutional investor;

- The two above conditions shall be mentioned in the issuance conditions, management regulation or articles of association and listing prospectus, as well as in any other document relating to the issuance, trading, listing of securities issued by the SIC.

This new mechanism has significantly enhanced the legal certainty of institutional structures ensuring a liquid trading of the notes issued. In addition, the regulatory requirements and constraints are kept to a minimum because there is no need to protect the general investing public (and hence no requirement for supervision by the commission).

Other legal developments

With securitisation transactions usually including cross-border aspects, the recently enacted Code of Conflict of Laws (applicable as of October 1 2004) has resolved a number of previously open questions, but has also left a number of frequently asked queries unattended. For example, the requirements for effectiveness of the transfer of receivables (or the granting of rights *in rem*, such as pledges over such receivables) in regard to third parties are confirmed to be determined (from a Belgian conflict of laws view) by the law of the habitual residence of the transferring (or granting) party (or for corporations their main establishment) at the moment of the transfer of such receivables (or the granting of the rights thereon). This implies that the law chosen by the parties will govern the validity and binding nature of the transfer or pledge, but another set of rules may need to be respected in parallel to ensure that the transfer or pledge is duly effective against all other parties (including the bankruptcy trustee of the transferor or pledgee at the time of an insolvency event). As bank accounts and credit thereon arecommonly considered to be receivables, the granting by, for example, a US bank of a Belgian law pledge on an account held in Belgium would need to comply with US perfection requirements. This rule has been criticised and will likely be amended.

One other issue that remains is whether future receivables arising from existing contracts can be effectively transferred by way of an (undisclosed) assignment. This is particularly relevant for trade receivable securitisations involving automatic rollover mechanisms.

As with many other civil law jurisdictions, Belgian law considers security rights to be an accessory to the underlying debt. Where the equivalent of a security trust is needed for a loan origination designed to be refinanced, a parallel debt (or covenant to pay) mechanism (based on the civil law concept of *solidarité active/actieve hoofdelijkheid*) may achieve the same result.