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Structuring cross-border securitisations in Bulgaria

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Bulgarian companies and financial institutions have been slow to tap the cross-border securitisation market. In fact, the sole cross-border securitisation involving a Bulgarian corporate or financial institution as originator has been the securitisation of part of the consumer loan portfolio of ProCredit Bank (a mid-size Bulgarian commercial bank), which closed a few years ago. Nevertheless, as Bulgaria's economy matures, it will not be long before Bulgarian companies, banks and non-banks start to use cross-border securitisations to obtain lower-cost financing for their financial assets and remove these from their balance sheets to meet applicable accounting rules.

This chapter discusses the principal legal and tax issues that would arise in connection with a true-sale cross-border securitisation of accounts receivable involving a Bulgarian corporate or financial institution.

Corporates

The following issues would be relevant to a typical offshore true-sale securitisation transaction of a company's accounts receivable (eg, trade receivables).

Effectiveness of accounts receivable transfer

This is the key legal issue in any securitisation. Bulgarian law allows for the assignment of rights (including accounts receivable) without the debtor's consent unless the law, the contract from which such rights originate or the nature of such rights prohibits assignment. Bulgarian law requires notification of the assigned debtor in order to perfect the assignment. Preferably, notification should be made through an instrument that is date certifiable (eg, sending via notary or same-day notary certification of the evidence of receipt of notice by the debtor).

Although failure to serve notice does not invalidate the assignment:

- a debtor that is unaware of the assignment can validly pay the assignor and thus discharge the debt;
- a third-party creditor of the assignor can claim interest in such debt (including arguing that the assignment was dated earlier, unless there is a certified date on the assignment instrument); and
- a debtor that has not consented to the assignment can offset the assigned debt against potential claims to the assignor.

In addition to the notice to the debtor, the originator (as assignor) must deliver to the issuer (as assignee) the documents proving the assigned debt and confirming the assignment in writing. Further:

- the assigned debt is transferred to the issuer together with all privileges, security, accrued interest and other accessories, unless expressly agreed otherwise;
- the originator is liable for the existence of the debt if assignment is made for consideration; and
- the originator is not liable for the debtor's solvency unless it is expressly agreed otherwise (even in such case, liability of the originator is limited by law to the consideration received).

Where there are third-party security providers which are different from the debtor, notice to such security providers must be served separately. If the securities attached to the assigned debt are to be entered in a special register, an additional note must be made of this. The law does not prescribe a specific form for the assignment; however, if the debt is secured with a mortgage, the assignment must be in writing with a notarised signature in order to be effective for the mortgagee.

Recharacterisation risk

Given that securitisation is in its infancy in Bulgaria, it would be difficult to ascertain the recharacterisation risk related to the assignment of accounts receivable. Still, provided that perfection of such assignment has taken place in accordance with the applicable general law, this should be sufficient to satisfy the true-sale criterion.

Suspect periods preceding insolvency during which a transfer can be set aside

The assignment of accounts receivable is null and void in relation to the creditors of the originator if:

- it is made before the issuance of the court ruling opening the insolvency procedure, but after the initial date of insolvency; and
- the receivables have been assigned either without consideration or for a consideration that is substantially less than the value of the receivables.

A major concern is that the Bulgarian courts are free to determine the initial date of insolvency retrospectively without any time limitation.

Further, the assignment of the receivables may be challenged and declared null and void regarding creditors of the originator if the assignment is made in the two years prior to the date of the opening of the insolvency procedure and:

- no consideration is paid;
- the consideration is substantially less than the value of the receivables;
- the transfer of title in settlement of the debt dates back to three months before insolvency;
- the creation/perfection of security on the originally unsecured debt dates back to one year before insolvency (two years in the case of a shareholder); or
- the assignment prejudices the creditors of the originator, provided that the assignee is an unlimited partner in the originator or a shareholder with 20 per cent or more of the shares, is a board

member of the originator or otherwise controls the activities of the originator (none of which should generally be the case in a securitisation).

In a properly structured securitisation, any preferential assignment risk would be small given that the consideration in exchange for which the issuer purchases the securitised accounts receivable is equal to or a discount on the accounts receivable, which is determined pursuant to sophisticated valuation techniques.

Approvals, filings or other actions necessary for the purchaser to collect the receivables

It is advisable to ensure that the assigned debtor has made proper entries of the accounts receivable and the change of creditor in its books. If the assigned debtor refuses to pay voluntarily, the issuer will have to litigate in Bulgaria. The issuer must advance the costs of litigation (which it can recoup if successful) and prove its title to the accounts receivable. To avoid any later arguments with the assigned debtor, the usual practice is for the debtor to sign the notification and then declare expressly that he or she agrees with the transfer and/or the pledge, and will not challenge it.

After successful litigation, enforcement through a bailiff (either a public officer or self-employed) will be required, including the further advance of (recoverable) costs depending on the method of enforcement.

If the assigned debtor becomes insolvent, the accounts receivable claim against the debtor's insolvency estate will be subject to the general insolvency rules. Upon the court decision declaring the debtor insolvent, any individual litigation or enforcement (except enforcement under a registered pledge, which is irrelevant here) will be stopped and the issuer must file claims with the bankruptcy trustee within one month of publication of the notice of insolvency (or can otherwise face the deferral of its rights). The issuer must attend general meetings of the creditors and may need to challenge certain acts or omissions of the bankruptcy trustee and/or other creditors, or defend itself against any such claims.

Data protection

Data protection rules are a consideration in the case of credit card receivables and consumer debt. Data protection legislation was introduced in Bulgaria in 2002. Although protection is available only to individuals, data relating to individuals acting as bodies of commercial companies is also protected. The data protection regulator has held that the sole mention of names is not disclosure of personal data. In any event, compliance with data protection rules will be judged on the basis of the terms of each contract whose receivables are subject to assignment.

The transfer of personal data outside Bulgaria requires permission from the regulator. Such permission will be granted only if the laws of the country to which the data is to be exported provide for the same or a higher level of protection than Bulgarian law.

Prevention of market abuse

If the assigned debtor is a public company, some clauses in the transaction may contain confidential information. To prevent any abuse of the financial markets, such information must be declared by law.

Costs

Bulgarian law does not impose stamp duty or other charges in connection with carrying out or perfecting an assignment of accounts receivable. Any costs of notarisation, sending notices by registered mail or registration of the creation and perfection of security will be negligible.

Tax

A Bulgarian originator will be liable to 10 per cent corporate tax on any income it realises from its own business activities. The income realised from the assignment of accounts receivable is added to this income.

No withholding or value added tax is payable in connection with the accounts receivable transfer. If the assignment contains clauses typical of factoring agreements (eg, provisions for counter-remuneration for the cessionary regarding collection of the assigned

receivable), the transaction will be taxable and value added tax will accrue. If the assignment is not made for value (which is allowed by Bulgarian law), and provided that the originator and issuer are related parties (which will almost always be the case), anti-avoidance rules would apply which regulate the transformation of the originator's financial result.

Miscellaneous

Bulgarian law does not recognise security trustees or similar concepts which are often employed in a securitisation. Bulgarian law and jurisprudence take the view that security rights are auxiliary to the main debt, and only a creditor of record (ie, with title to the underlying debt) can take associated security. Therefore, security rights cannot be transferred separately and where the accounts receivable are transferred, security rights must follow. Thus, the same person must be enforcing the accounts receivable debt and associated security. Recently, a parallel debt arrangement (ie, where the security trustee is constituted as an independent 'parallel' creditor under the loan, with discharge of the loan by the borrower under the parallel debt being a valid discharge for the purposes of the underlying loan obligations) has been employed in international loan financings of Bulgarian corporates, which may prove useful in structuring securitisation security packages in the future.

Also, typically the issuer appoints the originator to act as the servicer and collector of the accounts receivable, or a locally based representative to perform these services on the issuer's behalf.

Financial institutions

The following issues are relevant to a typical offshore true-sale securitisation transaction of a bank or non-bank's accounts receivable (eg, mortgage portfolio receivables). This section looks only at the areas that are specifically different from the issues raised by corporates.

Effectiveness of accounts receivable transfer

Mortgage loans and associated mortgage security can be transferred to an offshore issuer. The transfer must

be made in writing with notarised signatures of the parties and be recorded in the relevant land registers to be enforceable against the mortgagees. The non-resident issuer can register the mortgages through a local agent/attorney.

The Bulgarian Central Bank must be notified of the transfer. In addition, the transfer must be duly noted in the relevant register in order to achieve perfection.

Transfer of ancillary rights

The most common ancillary rights are property insurance and surety rights. Rights under insurance contracts are transferable together with the mortgage receivables, unless otherwise provided for in the insurance contract.

Surety agreements are transferable by way of written instrument and notification to the surety.

Non-resident issuer owning mortgaged property

The issue could arise on foreclosure of a mortgaged property. In a default by a mortgagee of land, the issuer may not bid at the public auction (which is required for mortgage foreclosure in Bulgaria) and have the land transferred to itself (which is also possible under Bulgarian law). This is because the acquisition of ownership rights of land is restricted for foreign persons (other than EU residents after 2014): foreign persons or entities are allowed to gain land ownership rights under the conditions of an international treaty ratified pursuant to Article 22(2) of the Constitution. Foreign physical persons are also allowed to inherit land ownership rights. Citizens of and entities based in EU member states or countries that are party to the European Economic Area Agreement may gain land ownership rights observing the statutory requirements in accordance with the Treaty of Accession 2005.

Protection from originator's bankruptcy of cash collections received into the servicer's account

If the originator also acts as servicer, in the event of the entity's bankruptcy the collection account may be affected. This can be mitigated by the issuer taking a

first-ranking charge over the account to secure debt (eg, on account of damages/indemnities under a service agreement) owed by the originator or servicer to the issuer.

Mortgagees' mandatory set-off right for any deposits with the originator

A mortgagee will enjoy mandatory set-off rights unless it has consented to the assignment. Therefore, notification of the portfolio mortgagees of the transfer will not prevent it from carrying out set-off on account of any deposits it may have with the originator.

Delegation by issuer of servicing, collection and foreclosure functions to the originator

Such delegation would be common as the originator is best placed to foreclose in accordance with the applicable Bulgarian law. However, given that the originator risk (both credit and operational) will not be fully isolated in this case, a back-up servicer may need to be appointed.

Costs

A mortgage portfolio transfer involves a notarial charge capped at Lev3,000 (approximately €1,500) and a Land

Register recording fee of 0.1 per cent of the value of the mortgage portfolio subject to transfer. These charges are assessable on the entire mortgage portfolio rather than each mortgage loan separately if the portfolio is transferred pursuant to one or more instruments (as should be the case in any event). Therefore, it is preferable to have all mortgage loans secured on properties in one location transferred pursuant to a single instrument.

Tax

A mortgage receivables securitisation attracts a withholding tax on the mortgage interest payable to the non-resident issuer. This tax is 10 per cent, unless avoided (in whole or in part) pursuant to a double tax treaty between Bulgaria and the jurisdiction in which the issuer is incorporated. Avoidance is possible upon obtaining treaty application clearance from the Bulgarian tax authorities. The clearance procedure is efficient and low cost.

No withholding or value added tax is payable in connection with the mortgage portfolio transfer, except that the non-resident issuer will be subject to Bulgarian withholding tax if it sells the mortgage loan at a profit.