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Still going strong: the Netherlands remains the jurisdiction of choice for structured finance transactions

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According to the European Securitisation Forum Securitisation Data Report (Winter 2008), European securitisation issuance fell in the fourth quarter of 2007 to €73.9 billion, compared to €107.8 billion in the third quarter and €184.9 billion one year ago. A substantial portion of the issuance volume was retained for internal or repossession purposes rather than distributed to investors. Second-half issuance declined by more than 42 per cent to €181.7 billion, from €315 billion in the first half. The reduced issuance volume in the second half of the year was the result of global credit market repricing and lower market liquidity. Based on the strength of a record first half, 2007 issuance totalled €496.7 billion, which was a 3.3 per cent increase on 2006. Residential mortgage-backed securities (RMBS) remained the largest issuing sector, accounting for 52.3 per cent of total issuance in 2007, compared to 50.9 per cent in 2006. In 2007 RMBS volume totalled €259.6 billion, compared to €244.6 billion in 2006. Collateral debt obligation (CDO) issuance was the second ranking product sector at €131.7 billion in 2007, compared to €110.1 billion in 2006. Commercial mortgage-backed issuance fell to €47.5 billion in 2007 from €59.9 billion one year ago. Issuance in 2008 is expected to be significantly lower than the elevated levels of recent years. According to the European Securitisation Forum, there will be a continuing trend towards higher-quality securitised collateral in lower-leveraged and less complex transactions.

The Netherlands has traditionally been one of the most popular special purpose vehicle (SPV) jurisdictions for cross-border structured note transactions such as repackagings, securitisations and CDOs. In 1996 the Dutch domestic

securitisation market started to attract investment and has been growing since then. Boosted by a favourable and stable market environment and strong investor demand, the Dutch securitisation market has seen massive growth over the past few years. In 2007 issuance backed by collateral originated in the Netherlands totalled €40.8 billion, a 43.2 per cent increase from the €28.5 billion issued in 2006 (excluding CDOs). Dutch RMBS volume totalled €35.3 billion in 2007, up from €26.5 billion in 2006. Commercial mortgage-backed securitisation was the second largest Dutch collateral sector in 2007 with an issuance volume of €4.8 billion.

Structures using the Netherlands

Dutch SPVs are typically set up as private companies with limited liability, whose shares are held by a Dutch foundation in order to achieve a standalone structure. An SPV can be incorporated within a couple of days. The only approvals required in relation to the incorporation of the SPV are a declaration of no objection from the Ministry of Justice and, normally, corporate tax clearance by the corporate tax inspector. The minimum share capital of an SPV is €18,000. The SPV is typically set up and managed by and domiciled at the address of a Dutch corporate service provider. This service provider usually provides the share capital and ensures that the issuer complies with Dutch legal, tax and reporting requirements. The issuer, the foundation and the corporate service provider enter into various agreements to provide that the structure remains standalone and to ensure the bankruptcy remoteness of the entire structure.

The benefits of choosing the Netherlands as the jurisdiction of choice for SPVs include the following:

- The Netherlands has a mature, suitable regulatory regime adopting the relevant EU directives.
 - There are no restrictions in relation to buying and investing in asset classes.
 - As result of a special structure and an agreement regarding the tax treatment between the SPV and the Dutch taxation authority, corporate tax is not imposed in the Netherlands on the transaction. The tax agreement provides the SPV with certainty in advance regarding its tax position and will be valid as long as instruments are outstanding.
- The Netherlands has a strong network of double taxation treaties with more than 75 jurisdictions.
 - In general, all payments by Dutch SPVs may be made free of withholdings or deductions on account of Dutch taxation.
 - There are no relevant Dutch stamp duty or similar documentary taxes.
 - In the case of managed transactions, management fees are normally exempt from Dutch value added tax.

Old regulatory regime

Prior to January 1 2007, Dutch SPVs involved in securitisations were considered 'credit institutions' within the meaning of the Act on the Supervision of Credit Institutions 1992. As a result, they needed to apply for a permit from, and were subject to supervision by, the Dutch Central Bank, unless an exemption applied. A separate regulation set out the requirements for exemption from the licence requirements and supervision. In addition, the Dutch Central Bank, in its capacity as primary enforcer of the act, published the Policy Rules of July 10 2002 (subsequently replaced by the Policy Rules of January 2 2005) to help entities to determine whether they qualified as credit institutions.

Two exemptions were provided:

- an SPV that attracted funding exclusively from professional market parties as listed exhaustively in the exemption regulation and/or one group of lenders/investors with which it forms a restricted circle; or
- an SPV that issued debt instruments to non-professional market parties, provided that:
 - it on-lent at least 95 per cent of its balance sheet total within the group of companies to which its belonged; and
 - all of its borrowing was supported by eligible credit support.

As SPVs are typically created as orphans, the first listed exemption was the only exemption available to most structures.

The exemption regulation contained a list of professional market parties (cut down from 13 to five categories by the 2005 amendment). In addition, the cross-reference to 'professionals' within the meaning of the former Securities Market Supervision Act was a welcome simplification and broadening of the professional market parties definition within the Act on the Supervision of Credit Institutions and related regulations.

Entities relying on the first exemption had to verify whether a lender or prospective note holder qualified as a professional market parties. However, when issuing notes to a large unknown group of investors, it may be difficult to ascertain the identity (and thus the quality) of such investors. To overcome this difficulty, the Policy Rules 2002 provided a safe harbour for verifying the identity of noteholders: an entity issuing notes in denominations of €500,000 which were either cleared through a clearing system or initially sold to a professional market party which was expected to re-sell exclusively to professional market parties was allowed to assume that buyers of such notes were professional market parties. After discussions with industry participants, and following the trends set by the EU Prospectus and Investment Services Directives to assume professional market party status at lower denominations, the Policy Rules 2005 lowered the threshold from €500,000 to €100,000, a move which was generally seen as an improvement for the marketability of the notes issued by SPVs. The safe harbour did not provide for a similar rule when funding was obtained other than by way of issuing notes.

Finally, entities qualifying as exempt credit institutions were required to notify the Dutch Central Bank that they had become active as such.

Current regulatory regime

After various delays, on January 1 2007 the new Act on Financial Supervision came into force, replacing eight financial legislative acts including:

- the Act on the Supervision of Credit Institutions;
- the Securities Market Supervision Act 1992;
- the Act on Supervision of Insurance Companies 1993;
- the Investment Act; and
- the Financial Services Act.

The objectives of the Act on Financial Supervision are to:

- make the legislation more transparent and more market oriented;
- simplify the rules with which financial institutions must comply; and
- harmonise the regulations that apply to different types of institution.

The introduction of the Act on Financial Supervision was not intended to change the legal framework materially. As an example, structures using Dutch SPVs still need to be set up in a manner that does not trigger banking licence requirements. Instead of a definition of 'credit institution' and an exemption regulation providing for exempt credit institutions, the act uses a definition of 'bank' which in itself provides an escape from the banking licence requirement. Article 1:1 of the act defines a 'bank' as "an entity that is in the business of obtaining repayable funds outside a closed circle from others than professional markets parties and of providing credit".

Professional market parties

'Professional market parties' are defined in Article 1:1 of the Act on Financial Supervision and consist of:

- qualified investors;
- subsidiaries of qualified investors, provided that such subsidiaries are subject to supervision on a consolidated basis;
- legal entities with a balance sheet total of at least €500 million as per the balance sheet as of the year end preceding the date on which they purchase or acquire the notes;

- individuals or companies with net equity of at least €10 million as per the balance sheet as of the financial year end preceding the date on which they purchase or acquire the notes and who or which have been active in the financial markets on average twice a month over a period of at least two consecutive years preceding such date;
- legal entities which have a rating agency rating that is recognised by the Dutch Central Bank or which issue securities that have a rating from such rating agency;
- legal entities established for the sole purpose of:
 - transactions that serve as security for securities (to be) offered;
 - transactions for the investment that may be settled by transfer of receivables to such legal persons or companies, while the rights pursuant to the sub-participations or derivatives will be used as security for the securities (to be) offered; or
 - providing credit for the benefit of investors and their subsidiaries as referred to under the two points immediately above.

'Qualified investors' are defined as:

- legal entities licensed or otherwise authorised or regulated to operate in the financial markets;
- legal entities without a licence and not so authorised or regulated to operate in the financial markets, with the sole corporate purpose to invest in securities;
- national or regional governments, central banks, international and supranational institutions and similar international institutions;
- legal entities with their seat in the Netherlands which have been registered as qualified investors by the Netherlands Authority for the Financial Markets and which meet at least two of the following three criteria:
 - an average number of employees over the financial year of fewer than 250;
 - a balance sheet total not exceeding €43 million; and
 - an annual net turnover not exceeding €50 million;
- legal entities which, according to their most recent (consolidated) annual accounts, meet at least two of the following three criteria:
 - an average number of employees over the financial year of at least 250;
 - a balance sheet total in excess of €43 million; and
 - an annual net turnover in excess of €50 million;
- individuals domiciled in the Netherlands who have been registered as qualified investors by the Netherlands Authority for the Financial Markets and who meet at least two of the following three criteria:
 - transactions of a significant size carried out on securities markets at an average frequency of at least 10 per quarter over the previous four quarters;
 - a securities portfolio in excess of €500,000; and
 - at least one year's experience working in the financial sector in a professional position which requires knowledge of securities investment; and
- individuals or enterprises considered as qualified investors in another member state pursuant to Article 2(i)(e)(iv) or (v) of the EU Prospectus Directive.

The Act on Financial Supervision and its rules and regulations do not include the safe harbour. However, in a letter of December 15 2006 the Dutch Central Bank announced that it had agreed with the Ministry of Finance to re-introduce the safe harbour in an amendment to the Act on Financial Supervision. Rather than providing for a safe harbour in the manner of the Policy Rules 2002, it is intended to create a new category of professional market

party, which will consist of individuals or entities from which funding is obtained by way of the issuance of notes, or pursuant to a credit agreement, if the denomination of the notes or the amount borrowed is at least €50,000 (or equivalent in foreign currency) or if the notes or the receivable under a credit agreement has been acquired for a consideration of €50,000 (or equivalent in foreign currency). It has been agreed that the market can act in anticipation of this amendment.

The intended re-introduction of the safe harbour is an improvement on the safe harbour provided for in the 2002 Policy Rules. First, the required amount has been lowered from €100,000 to €50,000, bringing it into line with the former securities market regulations and the EU Prospectus Directive. Second, in addition to providing a safe harbour when notes are issued, it can be assumed that a creditor qualifies as a professional market party even if the funding is obtained by way of a loan rather than by issuing notes.

Other changes

Although the objective of the Act on Financial Supervision was to combine all financial legislation into one act, it also made changes to the existing regime.

Dutch Central Bank notification

Under the former regime, an entity which qualified as an exempt credit institution was required to notify the Dutch Central Bank of its activities. This notification requirement has not been included in the Act on Financial Supervision, and as long as SPVs ensure that they do not fall within the definition of a 'bank', they can enter into transactions without becoming subject to a similar notification requirement.

Verification of professional market party status

Although an SPV is still under a duty of care to ensure that its creditors are professional market parties, the more onerous duty to verify the actual status of its creditors, as set out by Articles 2(4) and (5) of the 2002 Policy Rules, has been abandoned.

Consequences of breach

Prior to January 1 2007, Dutch legislation was silent on the civil law consequences of a breach of provisions in the Act on the Supervision of Credit Institutions or the Securities Market Supervision Act 1992, or the regulations pursuant thereto relating to the offering of securities and the raising of repayable funds. The Act on Financial Supervision now explicitly provides that a legal action in breach of the act cannot be null and/or void. However, breach still remains an economic offence.

Tax regime

Theoretically, many taxes could apply to structured finance transactions in the Netherlands (eg, corporate income tax, withholding tax and value added tax). However, in most Dutch transactions these taxes play no role.

Most Dutch issuers are structured in such a way that corporate income tax is not an additional cost to the transaction and, further, that no withholding tax need be deducted by the issuer from any payments made under a debt instrument issued by it. Previously, careful structuring was required when a debt instrument had a hybrid nature and when its maturity was in excess of 10 years. Under the current tax regime, which came into force on January 1 2007, the rules have been further relaxed: in general, a debt instrument of a hybrid nature which has a maturity of not more than 50 years is now fine for tax purposes. Therefore, careful tax planning is still required only for hybrid instruments of 50 years or more. However, for these 50-year-plus instruments, various technical solutions have been developed which mitigate any possible adverse corporate income tax and withholding tax issues relating to such instruments without harming the nature of the instruments.

In recent years, the Netherlands has also become an important home to SPVs that issue managed collateralised debt obligations and collateralised loan obligations. Value added tax on portfolio management services rarely plays a role and, if applicable, in general any negative impact can be mitigated through the application of exemptions and confirmation thereof by the Dutch taxation authority.

Conclusion

Issuance in 2008 is expected to be significantly lower than the elevated levels in recent years. There will be a trend towards higher-quality securitised collateral in lower-leveraged and less complex transaction structures. The other trends in increasing numbers of investors, additional asset classes and increasing numbers of countries of collateral are continuing and are important factors going forward.

The landscape of securitisation and structured finance is constantly changing. Increasing market

demand for more competitive financing instruments has given rise to the need for increasingly innovative transaction structures. The Dutch legal system has developed in line with this trend in order to accommodate market needs.

Although the Netherlands already had a mature regulatory regime and a popular tax regime, it has proved to be friendly as the jurisdiction of choice for SPVs. In 2008 it will become a major contender as a jurisdiction for structuring cross-border securitisation and structured finance transactions.