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Securitisation in Romania – legal and regulatory framework

Cristina Virtopeanu

Nestor Nestor Diculescu Kingston Petersen

A dedicated package of laws regarding securitisation was passed by Parliament in 2006, creating a legal framework for the issuance of covered bonds, as well as for off-balance sheet securitisation deals through special purpose vehicles (SPVs), and offering investors access to financial instruments backed by a portfolio of receivables originated in Romania.

The framework comprises:

- Law 31/2006 regarding the securitisation of receivables (the Securitisation Law), which creates the legal framework for the issuance of asset-backed securities through an SPV;
- Law 32/2006 regarding mortgage bonds (the Mortgage Bonds Law), which deals with the issuance of mortgage-covered bonds by credit institutions; and
- Law 33/2006 regarding mortgage banks, which introduces the concept of mortgage banks, which are able to issue mortgage bonds.

Three regulations implementing the framework and issued by the National Securities Commission came into force in July 2006. All three regulations provide in greater detail the regulatory requirements applicable to the market players involved in the issuance of bonds or asset-backed titles.

The regulation regarding securitisation of receivables sets out the requirements to establish an SPV or an entity to manage an SPV, as well as details regarding the minimum information to be included in the prospectus and other authorisation requirements.

Onshore versus offshore securitisation

The Securitisation Law allows an originator of receivables to sell both existing and future receivables to an SPV established as a securitisation fund or securitisation company, which is designed under Romanian law to mirror the features of a limited purpose conduit. Depending on its legal form (ie, a fund or a joint stock company), an SPV may serve to allow financing in a pay-through or pass-through securitisation scheme.

The Securitisation Law provides innovative legal solutions that derogate from the general law to address fundamental securitisation concepts, including:

- the concept of true sale;
- the concept of bankruptcy remoteness;
- no claw-back provisions; and
- the limitation to 45 days of the period within which the creditors of the originator may challenge the assignment of the receivables portfolio to an SPV.

The conditions imposed by the National Securities Commission regarding the minimum capital requirement for the SPV (ie, €25,000) and the establishment of the SPV specialised management company (ie, that it must be a specialised service provider, subject to National Securities Commission supervision, with a minimum capital of €125,000 and at least two shareholders which are credit or financial institutions) may render the establishment of a domestic SPV less attractive in terms of costs and formalities.

In a recent official interpretation, the National Securities Commission ruled that a foreign entity of another member state, authorised by the legislation of that member state to carry out SPV management, may act as a management company for an investment vehicle established in Romania under the provisions of Law 31/2006. This approach may have a positive impact on the costs and timeframe for the establishment of the SPV by permitting the management of an SPV by an entity set up and authorised abroad.

As the Securitisation Law regulates only domestic securitisation transactions, and due to the fact that the Romanian SPV may not act as a sub-SPV in a cross-border transaction due to the restrictions on selling the portfolio of receivables, the options available under Romanian law are to choose either:

- an onshore securitisation by establishing a Romanian SPV, benefiting from the provisions of the Securitisation Law; or
- an offshore securitisation by the assignment of receivables to an offshore SPV, structured under general civil law principles without the benefit of the securitisation-friendly provisions of the Securitisation Law.

Developments following EU accession

Banking Law

On January 1 2007, following Romania's accession to the European Union, a significant package of primary and secondary banking legislation came into force as part of the process of harmonisation with EU law.

The new Banking Law transposes the EU Banking Directive (2006/48/EC) and the EU Capital Adequacy Directive (2006/49/EC).

In keeping with the Banking Directive, the new Banking Law implements the principle that minimum capital requirements are established in close relation with weighting assets and off-balance sheet items, according to the degree of related risk.

Risk deductions arising from credit institutions' securitisation activities and investments must be appropriately reflected in the minimum capital requirements of the credit institution, which is required to apply a risk-sensitive and prudentially sound treatment of such investments or schemes.

National Bank of Romania and National Securities Commission regulations

In light of these changes, the National Bank of Romania and the National Securities Commission have jointly issued a package of regulations. The following affect both traditional and synthetic securitisations for banks benefiting from the Basel II rules regarding risk asset calculations:

- Regulation 13/18/2006 concerning the determination of minimum capital requirements for credit institutions and investment firms;
- Regulation 14/19/2006 on credit risk treatment using the standardised approach for credit institutions and investment firms;
- Regulation 15/20/2006 on credit risk treatment using the internal models-based approach for credit institutions and investment firms;
- Regulation 19/24/2006 on credit risk mitigation techniques used by credit institutions and investment firms;
- Regulation 20/25/2006 on the treatment of counter-party credit risk of derivative instruments, repurchase transactions, securities or commodities, lending or borrowing transactions, long settlement transactions and margin lending transactions; and
- Regulation 22/27/2006 regarding the capital adequacy of credit institutions and investment firms.

Of particular interest is Regulation 21/26/2006 regarding the treatment of the credit risk associated with securitisation, which is designed to ensure that credit risk from securitisation activities is included in the calculation of banks' capital adequacy ratios.

Regulation 21/26/2006 establishes the method to determine the risk-weighted values of securitisation exposures and applies to:

- credit institutions;
- Romanian legal persons;
- branches of foreign credit institutions in Romania; and
- financial investment companies and management companies licensed to administrate individual portfolios of investments (applicable on both an individual and a consolidated basis).

It provides definitions of 'securitisation', 'traditional securitisation' and 'synthetic securitisation', representing a significant step forward in delineating specific features and treatment of true sale versus synthetic securitisation, and in providing the rules for risk-weighting and achieving capital relief.

Thus, 'traditional securitisation' (or 'true sale') is defined as the economic transfer of securitised exposures from the originator credit institution to an SPV, either by transferring the ownership over the securitised exposures from the originator credit institution or by sub-participation. The securities issued by the SPV do not represent payment obligations of the originator credit institution.

'Synthetic securitisation' is defined as the establishment on a contractual basis of credit risks on tranches by the use of credit derivatives or guarantees, with the pool of securitised exposures remaining in the balance sheet of the originator credit institution.

In the case of a traditional securitisation, a credit institution may exclude from its calculation of risk-weighted exposure amounts the exposures which it has and, as relevant, expected loss amounts if a significant credit risk associated with the securitised exposures has been transferred to third parties and the transfer observes the minimum requirements provided under Annex IX, Part 2.1(a) to (g) of the Banking Directive.

For a synthetic securitisation, the credit institution must calculate the risk-weighted exposure amounts and, as relevant, expected loss amounts in respect of the securitised exposures if a significant credit risk associated with the securitised exposures has been transferred to third parties by either funded credit protection or unfunded credit protection if the minimum requirements provided under Annex IX, Part 2(a) to (d) are met, as follows:

- The securitisation documentation reflects the economic substance of the transactions.

- The credit protection by which the credit risk is transferred complies with the eligibility criteria for the recognition of such credit protection provided by Regulation 19/24/2006 regarding credit risk mitigation techniques used by credit institutions and investment firms. Regulation 19/24/2006 contains definitions of 'funded' and 'unfunded' protection, and provides for the eligibility criteria for funded protection and financial instruments that may be used as guarantees, as well as the eligible protection seller institutions and credit derivatives eligible for credit-risk mitigation. It expressly states that SPVs are not considered as eligible unfunded protection providers.
- The instruments used to transfer credit risk do not contain terms and conditions that would:
  - impose materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;
  - allow for the termination of the protection due to the deterioration of credit quality of the exposures;
  - require positions in the securitisation to be improved in cases other than early reimbursement; or
  - increase the credit institution's cost of credit protection or the yield payable to holders of securitised positions due to the deterioration of credit quality.
- A legal opinion has been obtained with respect to the enforceability of the credit protection.

Regulation 21/26/2006 also provides that, in the case of securitisation in tranches, the exposure for each tranche is regarded as a distinct securitisation, with the requirements regarding the calculation of risk-weighted exposure amounts and expected loss being performed accordingly.

Risk assessment

The new Banking Law allows credit institutions to use both external estimates (ie, a standardised approach) and internal ratings to assess the credit risk associated with securitised exposures.

When determining the risk-weighted exposure amount using the standardised approach, a credit institution may use a rating furnished by an external rating institution if such institution has been recognised as eligible by the National Bank of Romania.

Regulation 3/2008, issued in January 2008 by the National Bank of Romania, provides the framework for recognition of external rating institutions.

The single passport principle available under the EU Banking Directives applies to external rating institutions. Thus, if an external rating institution has been recognised as eligible by the competent authority in a member state or by the European Commission, no evaluation will be performed by the National Bank of Romania to recognise it. The National Bank of Romania must publish the assessment process and the list of external credit assessment institutions recognised as eligible.

Credit institutions may obtain permission to use an internal ratings-based approach only if the National Bank of Romania is satisfied that the implemented systems for the management and rating of credit-risk exposures comply with the standards and minimum requirements for the assessment of conformity.

If a Romanian credit institution is an EU parent credit institution, or a subsidiary of an EU parent credit institution or of an EU parent financial holding company, and the parent group employs an internal ratings-based approach on a unified basis, the National Bank of Romania may allow the minimum requirements to be met by the parent undertaking and its subsidiaries considered as a whole.

Credit institutions which obtain approval to use the internal ratings-based approach must implement the internal ratings-based approach for all exposures.

In addition, the National Bank of Romania may approve the sequential implementation of the internal ratings-based approach, provided that this treatment is not used selectively by the credit institution in order to achieve lower capital requirements.

Conclusions and predictions

Covered bonds benefit from a legal framework that now has all the essential elements to allow the first issuances of bonds backed by a pool of mortgages originated in Romania.

Although more complicated than the issuance of bonds, securitisation – whether a true sale or synthetic - may prove an attractive tool, particularly for credit and financial institutions falling under the scope of the new capital adequacy rules.

The implementation into national law of the Basel II-related EU norms is a laborious process which will require careful review to ensure the consistent application of EU legislation and will entail further clarification from the Romanian regulator, as well as the incorporation of lessons learned from the experience of more sophisticated securitisation markets.

Nevertheless, the securitisation-specific regulations issued by the National Bank of Romania and the National Securities Commission represent a step forward as the Romanian authorities recognises securitisation deals and provides for a framework regarding the treatment of such exposures and the imposition of capital adequacy requirements within the boundaries of EU law.