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Securitisation in the Slovak Republic

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Despite there being no reported securitised transaction in the Slovak Republic to date, this chapter describes and discusses the vast potential for the use of securitisation products in the Slovak Republic, as well as the existing legal infrastructure which is capable of supporting such activity.

Potential for securitisation

In the Slovak Republic, most assets which have a reasonably steady and predictable cash flow can potentially be securitised, such as:

- domestic and cross-border receivables;
- loans;
- bonds;
- leases;
- export proceeds;
- trade receivables;
- equipment loans and leases;
- social and healthcare insurance receivables;
- credit card receivables; and
- mortgage-backed bonds issued by banks or branches of foreign banks licensed to provide mortgage loans.

Following a series of successful privatisations of leading banks and corporations, several capital market players have been looking at the Slovak Republic as a potential location for securitisation techniques, particularly as it has seen such a boom in the residential mortgage and car lease markets. However, while in other countries banks are in need of new capital, in the Slovak Republic the banks face the opposite problem of seeking ways to use

their funds efficiently and to diversify their financial product range through securitisation.

The privatisation of banks and corporations has prompted the appearance of several structured finance arrangements in the Slovak Republic, which until recently were based only on sales of underperforming assets and loans. Some transactions resembling certain aspects of securitisation have been seen in the sale of non-performing loans and trade receivables by newly privatised financial institutions and privatised corporations to *Slovenska Konsolidacna Agentura* (SKA), the state debt consolidation agency.

Historically, the largest single package of receivables (2,479 receivables from 800 debtors with an aggregate face value of SKr42.9 billion) was sold by SKA through a public tender to Majetkovy at the end of 2003 for a profit margin of 2.85 per cent.

Securitisation projects in the Slovak Republic are likely to increase as they can provide a less costly source of long-term financing for some companies, particularly those with a rating that is below investment grade or unrated. Financial covenants are also often less burdensome in a securitisation than in a traditional bank financing. Increasing interest by Slovak regulators and financial institutions may also provide the necessary push to the Slovak government to implement the changes necessary to facilitate true-sale transfers of various types of domestic and cross-border receivable, both existing and future flow.

Legal and regulatory issues

At present, no specialised securitisation legislation exists in the Slovak Republic, although this may not pose a major obstacle as the existing legislation does provide a basic framework for securitised transactions.

Five years ago the National Bank of Slovakia undertook a regulatory and legal analysis of securitisation in the Slovak Republic in an attempt to improve the legal environment for domestic securitisations. No specific legislation regarding securitisation has yet been passed, although certain changes in the banking and regulatory framework relating to the implementation of the EU Credit Institutions Directive (2000/12/EC) and the EU

Capital Requirements Directive (comprising Directives 2006/48/EC and 2006/49/EC) became effective on January 1 2006 and January 1 2007, respectively. Changes have also been introduced to the Civil Code and the bankruptcy, banking and securities laws.

At present, a securitised transaction falls within the general jurisdiction of civil and finance laws, including:

- the Civil Code;
- the Commercial Code;
- the Banking Act, together with various regulations of the National Bank of Slovakia;
- the Securities Act;
- the Bonds Act, including provisions on mortgage-backed securities;
- the Bankruptcy Act;
- the Foreign Exchange Act;
- the Accounting Act and various Ministry of Finance measures on accounting regarding securities created in the process of securitisation; and
- the Income Tax Act.

Choice of law and enforceability of foreign judgments

Parties to a contract can choose a foreign law as the governing law of a contract if a foreign element requirement is satisfied. This element requires that one of the parties is not a Slovak resident. Similarly, Slovak law recognises the right of the parties to a contract to choose a foreign (ie, non-Slovak) forum for dispute resolution. The provisions of a contract governed by foreign law will be valid and enforceable, except where the provisions contradict the principles of public order applicable under Slovak law.

However, some aspects of a securitised transaction are governed by the law applicable to the receivables to which the assignment relates, including:

- the valid assignment of receivables;
- the relationship between the special purpose vehicle (SPV) and the debtor;
- the conditions under which the SPV can invoke the assignment against the debtor; and

- the question of whether the debtor has properly discharged its obligations.

When drafting contractual documentation, it is important that EU Regulation 44/2001 is observed.

The Slovak Republic is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention). Therefore, foreign arbitral awards made in the territory of the foreign contracting state are enforceable in the Slovak Republic. Arbitral awards made in the territory of any other state shall be recognised and enforced only on the basis of reciprocity.

Transfer issues

Slovak law allows receivables to be transferred by an assignment of existing claims. A creditor can assign its receivables, together with all rights attached thereto, without the debtor's consent. The assignment of the receivables from the originator to the SPV need not be notified to the debtor or registered with any other authority in order to be valid. However, a written agreement between the assignor and the assignee is necessary. In practice, the debtors will continue discharging their payments to the account of the originator set up for collecting monies from the pool of financial assets included in the conduit and the SPV will have security over the bank account. The balance of the collection account should be regularly transferred to the transaction account established in the name of the SPV. Once the debtors are notified of the assignment they are obliged to pay directly to the SPV's transaction account, subject to bankruptcy considerations.

A major limitation of the transfer is the 'no assignability' provision regarding rights, claims or even obligations in the underlying asset agreement with the debtor. This is a key issue which should be addressed when drafting the agreement documenting the receivables (eg, loan, mortgage or lease agreements) in order to permit securitisation of such receivables in the future.

Slovak law permits the valid transfer of future receivables (ie, future receivables payable under both

existing and future contracts), subject to a clear identification of all rights and claims assigned under the agreement at the time of assignment and the expressed intention of the parties to assign such future receivables. Identification of the claims is achieved through regular updates of the lists of assets (eg, payments and interests), as well as an updated list of contracts subject to sale. However, it is advisable to have an agreement on future contracts embedded in the assignment agreement in relation to receivables arising under contracts that do not exist at the time of closing, but which are expected to come into existence at a future date.

True sale and bankruptcy remoteness

According to Slovak law, if a certain legal act (eg, an agreement) is intended to conceal another legal act, the concealed legal act is valid provided that it corresponds to the intention of the parties and has all requisites of such an act under the law. Therefore, a true sale will be accomplished if the intentions of the parties are to transfer the ownership title to the securitised assets instead of, for example, creating a security interest.

As a result of such transfer, the SPV will hold a valid ownership title to the assets and such transfer of ownership will remain valid in the event of bankruptcy or liquidation of the originator, unless the bankruptcy administrator successfully avoids such transfer of ownership. However, this will be difficult to establish if the transfer of receivables from the originator to the SPV was for fair consideration, particularly if such consideration corresponded to the actual value of such assets or if an independent appraisal was obtained.

Under the Bankruptcy Act (effective as of January 1 2006), a debtor is insolvent if:

- it is in payment insolvency – that is, the debtor has more than one creditor and is unable to fulfil more than one monetary obligation 30 days after the due date; or
- it is in excessive indebtedness – that is, the debtor, subject to bookkeeping requirements under Slovak

law, has more than one creditor and the value of its due obligations exceeds the value of its assets.

The process of determination of payment insolvency and excessive indebtedness are set out by decree. The creditor is authorised to file a bankruptcy application if the debtor defaults on its monetary obligation by more than 30 days and it can be reasonably assumed that the debtor is in payment insolvency. Payment insolvency of the debtor can be reasonably assumed if the debtor is in default of fulfilling of at least two enforceable or written monetary receivables of at least two creditors for more than 30 days, despite being asked by the creditors in writing to pay them.

Upon a declaration of bankruptcy, power to dispose of the debtor's property subject to the bankruptcy and power to act on the debtor's behalf in matters relating to such property is vested in a bankruptcy administrator. Any undue receivables and obligations of the debtor that originated before the declaration of bankruptcy and relate to property subject to the bankruptcy are deemed to be due.

Opposition to legal acts by bankruptcy administrator

The Bankruptcy Law allows the bankruptcy administrator to contest the following legal acts, provided that such legal acts defraud the settlement of a registered receivable of any of the debtor's creditors:

- legal acts without reasonable consideration that caused the debtor's insolvency or were performed during the debtor's insolvency;
- preferential legal acts that caused the debtor's insolvency or were performed during the debtor's insolvency;
- fraudulent legal acts by which the debtor defrauded its creditors, provided that such legal acts were performed with intent by the debtor to defraud creditors and such intent was or must have been known to the other party; and
- legal acts performed after the bankruptcy was cancelled, provided that the bankruptcy was

repeatedly declared on the debtor's property within six months after cancelling the original bankruptcy (this does not apply to ordinary legal acts).

Legal acts without reasonable consideration and preferential legal acts may be contested only if they occurred in the year before the commencement of preliminary bankruptcy proceedings (or, if performed in favour of an insider, in the three years prior to preliminary bankruptcy proceedings). Fraudulent legal acts may be contested if they occurred in the five years before the commencement of preliminary bankruptcy proceedings.

Under the Bankruptcy Act, it is not possible to ensure that the bankruptcy administrator will not challenge a transfer carried out in the 12 months before the commencement of preliminary bankruptcy proceedings. Therefore, it is difficult to develop a structure that will absolutely protect the assigned assets from the bankruptcy administrator. However, the risk of successful challenge by the bankruptcy administrator may be mitigated if transfers of securitised assets are:

- truly intended by the parties; and
- carried out in the proper form and for adequate consideration.

In addition, a mechanism which clearly separates individual transactions would mitigate the risk of exposure by ensuring that not all individual transactions are subject to the same risk. The structure of the transaction should provide the means to ensure that assets are available to make interest and principal payments in a timely manner, notwithstanding the insolvency of the originator. In addition, creditors' prospects are substantially improved by being secured creditors.

Regulatory issues

Slovak law requires no specific authorisation from the financial services regulator for the purchase of a pool of receivables. Under Slovak law, receivables may be purchased by factoring or sale and purchase, provided

that the purchaser possesses the appropriate trade licence, which can be obtained through notification and registration with the Trade Licence Registry.

If, after the transfer of the receivables to the SPV, the originator continues to service the receivables, in general the originator or servicer requires no licence or authorisation from any Slovak government body, unless it is classified as asset management (which may occur under certain limited circumstances) and is thus subject to a different regulatory regime.

Under Slovak law, a mechanism may be established to achieve isolation of the receivables collected by the originator or servicer so that they are excluded from the bankruptcy estate of the originator upon the originator's insolvency. Assets can be sold directly to a foreign SPV and there are no regulatory issues requiring the establishment of a local SPV, even with respect to consumer receivables or consumer credit act compliance licence requirements, with the exception of cross-border transfer of data under Slovak data protection laws.

In general, Slovak legislation does not restrict the originator's disclosure of the terms or parties of underlying receivable agreements to the SPV or any another party to the transaction. This is subject to any contractual restrictions on confidentiality agreed between the originator and the debtors in the underlying agreements, as well as data protection and banking secrecy laws. The Data Protection Act does not apply to legal entities, but regulates the protection of personal data relating to natural persons. Therefore, data protection may be an irrelevant issue if the bulk of receivables transferred from the originator are exclusively held by legal entities.

Security interests

Slovak law does not include the concepts of floating charges or negative pledges. However, following reforms to the Law on the Establishment and Perfection of Charges 2003, it is possible for a debtor to create security in favour of creditors over any asset class, including future assets, provided that such assets may be identified during the entire term of the security.

Tax issues

Slovak law does not impose stamp duty in connection with the sale of receivables to an SPV. The tax implications of a particular securitisation may depend on the type of receivables, as well as whether the transaction is cross border or purely domestic. The income of a Slovak tax non-resident received on any transfer of receivables to a Slovak tax resident is not regarded as sourced in the Slovak Republic and is therefore not taxable in the Slovak Republic.

Income from the transfer of receivables received by the originator from the SPV is taxable in the Slovak Republic only if the originator is a Slovak tax resident or if the income is attributable to the originator's Slovak permanent establishment. The related capital gains from such a transfer are subject to a Slovak corporate income tax flat rate of 19 per cent. Any loss incurred from the transfer of a receivable is not tax deductible (with limited exceptions).

In general, the originator's tax-deductible expense is either:

- the nominal value of the transferred receivable (for its own receivables); or
- the acquisition value of transferred receivables (for receivables acquired from another person).

The originator may also transfer receivables to the SPV by an initial contribution to the SPV's registered capital or by a further increase of existing capital. Such transfer is subject to neither income tax nor gift tax. When the SPV subsequently transfers the contributed receivables, the tax-effective value of the receivable SPV equals the tax-effective value for the originator, regardless of the value of the receivable recorded in the SPV's books. A step-up in the tax values through contribution is not possible.

Tax withholding does not apply on a transfer or contribution of receivables by or to a Slovak tax resident, even if it is by or to a non-Slovak resident. Furthermore, the repayment of an acquired receivable by a Slovak tax resident is not subject to tax withholding, regardless of whether the receivable was acquired based on an

agreement or through a contribution. In certain cases the SPV may create tax-deductible bad-debt provisions based on the period for which the receivable is overdue. Such provisions may be created for receivables acquired both under an agreement and through a contribution.

The transfer and contribution of a receivable is not subject to value added tax. In addition, the transfer or acquisition of receivables, either under an agreement or through a contribution, is not subject to capital tax, stamp duty or similar transfer or capital tax.

Conclusion

The existing legislation provides a basic regulatory framework for securitisation, although certain risks and issues should be taken into account. Proper documentation, particularly in relation to regular cash-flow sweeps and careful assignment language, should be used to counter the risks of true-sale and bankruptcy issues. Another issue is the insufficient market volume of assets that can be pooled for a conduit, but multi-seller originator transactions may tackle this problem.