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Spanish securitisation transactions: legal regime and recent trends

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The sub-prime mortgage crisis in the United States did not have a major impact on the Spanish mortgage market until the last quarter of 2007. As a result, the number of securitisation transactions carried out in 2007 in the Spanish market increased in comparison to previous years, as stated in the bulletin for the fourth quarter of 2007 issued by the *Comisión Nacional del Mercado de Valores* (CNMV), the securities market regulator.

However, the enactment of Law 41/2007 of December 7 2007, which amended Law 2/1981, was an important milestone in Spanish mortgage market legislation. The amendments mainly affected the regulation of mortgage bonds and *cédulas hipotecarias*, but also some articles regarding *participaciones hipotecaria* (PHs) and *certificados de transmisión de hipoteca* (CTHs).

Legislative milestones

The framework for securitisation transactions was set out in Law 2/1981 and its developing regulations, as amended in 1991. The regulations created the PH, which allowed, upon its issuance, the underlying mortgage loan to be given a true-sale and off-balance sheet treatment in the accounts of the issuer without needing to re-register the mortgage loan in the name of the purchaser.

Securitisations were first regulated in Spain by Law 19/1992, which created a specific vehicle for the pooling of PHs, the *fondo de titulización hipotecaria*.

Law 3/1994 authorised the government to extend the provisions governing the securitisation of mortgage loans to other types of credit right.

Thus, in 1998 the government enacted Royal Decree 926/1998 in order to facilitate the securitisation of other categories of asset.

In recent years further legislative amendments have been introduced to strengthen the securitisation market. In particular, regulations enacted on December 30 2003 and November 10 2005 provided for and improved the legal framework for the securitisation of future credit rights and synthetics.

Mortgage loan and other asset securitisations

Fondo de titulización hipotecaria and fondo de titulización de activos

Both the *fondo de titulización hipotecaria* and the *fondo de titulización de activos* are funds (ie, pools of assets) without legal personality and thus need to be administered by a management company incorporated and authorised in Spain for that sole purpose. The management company is vested with the legal representation and defence of the bondholders' interests.

The incorporation of a *fondo de titulización hipotecaria* or *fondo de titulización de activos* must be authorised by the CNMV, the Spanish securities market regulator. Once approved, the granting of a notarial deed formally constitutes the *fondo de titulización hipotecaria* or *fondo de titulización de activos*.

In the case of a *fondo de titulización hipotecaria*, the assets of the fund will be the pool of PHs, whereas the liabilities correspond to the bonds issued. By law, a *fondo de titulización hipotecaria* is a closed-ended entity. Therefore, once incorporated, neither its assets nor its liabilities may be renewed or expanded.

In case of a *fondo de titulización de activos*, the assets of the fund will be the securitised rights of credit, whereas the liabilities correspond to the bonds issued. As opposed to a *fondo de titulización hipotecaria*, a *fondo de titulización de activos* can be open-ended regarding its assets and liabilities. This means that, once incorporated, an open-ended *fondo de titulización de activos* may continue to acquire rights of credit and/or issue new bonds in terms stipulated in its deed of incorporation.

The constitution of a *fondo de titulización hipotecaria* or *fondo de titulización de activos* further requires a prospectus to be approved and registered with the CNMV. However, in the case of a *fondo de titulización de activos*, an exemption from this requirement is available if the bonds issued by the fund are targeted only at institutional investors.

Securitised assets

Fondo de titulización hipotecaria

A *fondo de titulización hipotecaria* may only acquire or pool PHs. PHs are negotiable securities that incorporate a participation in the rights attached to a mortgage loan granted by a credit entity. Each PH must relate to a specified mortgage loan. The underlying mortgage loans continue to be serviced and administered by the issuer of the PH.

Law 41/2007 has clarified the legal regime of PHs, expressly foreseeing the need for mortgage loans underlying the issue of PHs to meet certain requirements provided for in Law 2/1981 (ie, conforming loans), including that:

- the issuer of the PH is a credit entity;
- the loan has as its main purpose the construction, renovation or acquisition of houses or other industrial or commercial buildings;
- the loan-to-value ratio does not exceed 60 per cent (80 per cent in the case of construction, renovation or acquisition of houses);
- the real estate property has been appraised; and
- the property is insured and free of charges.

Law 41/2007 further specifies that in respect of non-conforming loans (ie, mortgage loans that do not comply with all or some of the requirements set forth under Law 2/1981), only CTHs may be issued.

Pursuant to this recent amendment, CTHs may only be pooled into a *fondo de titulización de activos* or subscribed by a qualified investor (as defined in the legislation implementing the EU Prospectus Directive).

Law 41/2007 also regulates the option to issue PHs and CTHs in respect of loans secured with mortgages over real estate properties located in EU member states (provided that such mortgages are equivalent to those regulated under Spanish law, as determined by future regulations).

Fondo de titulización de activos

Royal Decree 926/1998 allows the assignment of rights of credit to *fondo de titulización de activos*. The decree also permits the assignment of future rights of credit to a *fondo de titulización de activos*, provided that an authorisation has been obtained from the minister of economy in the form of a ministerial order.

Pursuant to the 1998 decree, the assignment of the credit rights to a *fondo de titulización de activos* must be formalised in a contract and carried out in full, unconditionally and for the entire term remaining until the credits' final maturity. The originator may not grant any guarantee or assume any risk in respect of the insolvency of underlying debtors.

Securities issued

Fondo de titulización hipotecaria

A *fondo de titulización hipotecaria* may raise the funds required to subscribe the PHs only through the issue of fixed-income securities (ie, the bonds). Such bonds can have different levels of seniority and need to be represented by book entries, listed in a Spanish organised or official market and rated by an authorised rating agency in Spain.

Fondo de titulización de activos

As in the case of a *fondo de titulización hipotecaria*, bonds issued by a *fondo de titulización de activos* must, in principle, be listed in a Spanish secondary market and have a prospectus registered with the CNMV.

However, under the 1998 royal decree a *fondo de titulización de activos* may take advantage of the private placement exemption so that issues of bonds placed exclusively with institutional investors (which should now refer to 'qualified investors' as defined in the

legislation implementing the EU Prospectus Directive) need not be listed or have a prospectus registered with the CNMV.

As opposed to a *fondo de titulización hipotecaria*, which may raise funds only through the issuance of bonds, a *fondo de titulización de activos* may also obtain financing through loans and may receive special contributions from institutional investors (subordinated to any other creditor of the fund) up to a limit of 50 per cent of the liabilities of the *fondo de titulización de activos*.

Bankruptcy remoteness

According to the new Insolvency Law, which came into force on September 1 2004, a transaction entered into in prejudice of the debtor's bankrupt estate within two years of the bankruptcy may be challenged.

Law 2/1981, as amended by Law 19/1992, provided an exemption to the previous insolvency regime, under which a judge could backdate the effects of a bankruptcy to the date from which it deemed the debtor to be insolvent, thus nullifying all transactions performed thereafter. Pursuant to Law 2/1981 and Law 3/1994, the assignment of a loan through the issue of the PH (or, in the case of a *fondo de titulización de activos*, the assignment of the relevant credit rights) could not be affected by the backdating of the bankruptcy of the originator, unless in both cases the administrators could show that the issue of the PH or the assignment of the credit rights had been carried out to defraud creditors.

Law 2/1981 and Law 3/1994 further provided for a complete right of separation for the holder of a PH or of the securitised credit rights over the proceeds derived from the underlying mortgage loan or the underlying credit rights, provided that such right was acknowledged by the representatives of the insolvency estate or, where necessary, by a final judgment.

Following the enactment of the Insolvency Law, it was unclear whether the specific bankruptcy-remoteness regime and the right of separation provided in Law 2/1981 and Law 3/1994 still applied to *fondos de titulización hipotecaria* and *fondos de titulización de activos*.

This uncertainty has ended with the enactment of Law 41/2007, which expressly sets forth that in case of insolvency of the issuer of the PHs or CTHs, the relevant issue of PHs or CTHs carried out in the two years before the date on which the issuer was declared insolvent may be challenged only if such issue was carried out by defrauding creditors. A similar regime will apply to the assignment of credit rights pooled in a *fondo de titulización de activos* in the event of the insolvency of the assignor.

Taxation

Fondos de titulización hipotecaria and *fondos de titulización de activos* are subject to corporate income tax at the general rate of 35 per cent.

There is no withholding on the income obtained by the *fondo de titulización hipotecaria* or the *fondo de titulización de activos* from the PHs or securitised credit rights and the contracts entered into for credit enhancement purposes.

As regards stamp duty, it is clear that the issuance of PHs is free from any stamp duty. However, a careful analysis of the assets or rights of credit to be assigned will need to be made when structuring the transaction in order to avoid stamp duty arising in the transfer of the assets to a *fondo de titulización de activos*.

The tax regime applicable to the securitisation bonds issued by *fondos de titulización hipotecaria* and *fondos de titulización de activos* is discussed below.

Recent trends and legislative changes

Securitisation of future credit rights

On November 10 2005 a ministerial order was enacted to regulate the assignability of certain future credit rights to *fondos de titulización de activos*, pursuant to the 1998 decree (which sets out the need for authorisation to securitise this type of credit right, except for the collection rights of toll-road concessionaires).

According to the order, the following future credit rights may be securitised:

- the right of the lessor to collect the amounts due under a lease agreement;
- the proceeds or products deriving from the exploitation of works protected under and in accordance with the terms of the Spanish IP legislation, or under and in accordance with the terms of the applicable law in the case of works whose original country is not Spain;
- the proceeds or products deriving from the exploitation of trademarks or commercial names, provided that the relevant trademark or commercial name is duly registered in accordance with Spanish trademark legislation or complies with the applicable foreign law;
- the proceeds or products deriving from the exploitation of industrial designs, provided that the relevant industrial design is duly registered in accordance with Spanish industrial design legislation or complies with the applicable foreign law;
- the proceeds or products deriving from the exploitation of a patent, utility model or other industrial property right of an analogous nature, provided that the relevant industrial property right is duly registered in accordance with Spanish patent legislation or complies with the applicable foreign law;
- the rights to the proceeds of the consideration of the sale or supply of products or services on a single or continuous basis, provided that it has recurrent or single cash flows whose amount is known or can be estimated;
- the future credit rights corresponding to the income deriving from loans, credits or other types of financing and those deriving for the lender under drawdowns made by the borrower under credit agreements, as well as the right of the credit entity under the financings granted to any of the parties of the transactions referred to above or to any third party which subrogates in its contractual position; and
- the right of the beneficiary of a usufruct or other limited right *in rem* in respect of the economic value of the usufruct or of the relevant right.

The order further sets out the following requirements for the assignment of future credit rights:

- The assignment must be made in full and unconditionally.
- The deed of incorporation of the *fondo de titulización de activos* must include:
 - the terms of the agreement or activity from which the credit rights derive; and
 - the rights and powers of the assignor in respect of the assigned rights.
- The deed of incorporation of the *fondo de titulización de activos* must also include the terms of the full and unconditional assignment of the rights in favour of the *fondo de titulización de activos* (specifying, in particular, the term of the assignment as well as the allocation of risk between the assignor and the assignee). In particular, the deed of incorporation of the *fondo de titulización de activos* must expressly provide for the consequences for the assignee of the extraordinary circumstances which may result in the interruption, either definitive or provisional, of the cash flows deriving from the assigned rights. In this respect, the economic risk of the valuation of the actual amounts of the credit rights with respect to the amounts provided for by the time of the assignment may be totally or partially assumed by the assignor, provided that the assignor can never be liable regarding the *fondo de titulización de activos* for the solvency of the debtors under the assigned rights.

Extension of the tax regime under Law 19/2003

Law 23/2005 of November 18 2005 extended the special tax regime provided by Law 19/2003 to the issue of listed bonds by *fondos de titulización hipotecaria* and *fondos de titulización de activos*.

Therefore, listed bond issues by *fondos de titulización hipotecaria* and *fondos de titulización de activos* are taxed as follows:

- The issue of bonds by *fondos de titulización hipotecaria* and *fondos de titulización de activos* is not subject to indirect taxation (ie, capital tax and stamp duty); and
- The return to be paid on bonds issued by *fondos de titulización hipotecaria* and *fondos de titulización de activos* is a deductible expense for corporate income tax purposes.

In relation to the income derived from the securitisation bonds, the following considerations apply. For Spanish resident investors that are:

- individuals, the income derived from securitisation bonds will qualify as capital-sourced income subject to personal income tax at a fixed rate of 18 per cent; and
- legal entities, the income derived from securitisation bonds will be included in such entity's corporate income tax taxable income and, as a result, will be taxed at 30 per cent from 2008 onwards.

The following considerations apply to non-Spanish resident investors. In the case of non-Spanish resident investors not acting through a permanent establishment in Spain, the income derived from securitisation bonds will have the same non-resident income tax (ie, withholding tax) regime as that applicable to income derived for such investors from public debt issued by the Spanish government and other public bodies.

Accordingly, income derived from securitisation bonds will be exempt from non-resident income tax, unless the non-resident investors are acting through a tax haven. In this case, such income will be subject to 18 per cent non-resident income tax, which will be withheld by the *fondo de titulización hipotecaria* or *fondo de titulización de activos*. For the purposes of applying the withholding tax exemption, non-resident bondholders will have to comply with certain information obligations.

In effect, Law 19/2003 provides for certain identity disclosure obligations to be met by the *fondos de titulización hipotecaria* and *fondos de titulización de activos* in regarding to the Spanish tax authorities. These obligations were developed by Royal Decree 1778/2004, which came into force on August 8 2004 and provided that in January each year the relevant Spanish *fondo* will be required to provide the Spanish tax authorities with the following information:

- identification of the bonds issued;
- identity and tax residency of the bondholders – where the securities are held for the benefit of a third party, the identity and tax residency of such third party will also be required; and
- payments made to each bondholder.

For the purposes of preparing the return, the *fondo de titulización hipotecaria* or *fondo de titulización de activos* will have to obtain certain documents in respect of each non-resident bondholder proving its identity and tax residency.

Law 41/2007

Law 41/2007 has clarified the legal regime for PHs and CTHs, including their insolvency regime.

In this regard, the main changes implemented by Law 41/2007 in relation to securitisation transactions are as follows:

- The mortgage loans underlying the issue of PHs must be conforming loans and the mortgage loans underlying the issue of CTHs must be non-conforming loans;
- The CTHs must be subscribed by a *fondo de titulización de activos* or a qualified investor;
- In case of insolvency of the issuer of a PH or CTH, in order to challenge any such issue carried out within the two years before the declaration of insolvency, the insolvency administrators must prove fraud against the creditors;
- The same regime applies to the assignment of credit rights to a *fondo de titulización de activos* in case of insolvency of the assignor; and
- There is a new option to issue negotiable securities in respect of loans secured by a first-ranking chattel mortgage or a first-ranking pledge without transfer of possession, according to terms to be set out by forthcoming regulations. in the terms set forth in regulations to come.