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Securitisation and covered bonds in Sweden

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Securitisations have taken place in Sweden since the early 1990s and the financing technique is known to most Swedish corporates. The Swedish asset-backed securities market has been dominated by true-sale residential mortgage-backed deals featuring offshore special purpose vehicles (SPVs). However, in recent years new asset classes (eg, consumer credits, lease receivables, trade receivables, commercial mortgages and credit card receivables) have appeared. New transaction structures have also been developed, notably synthetic, secured loan and pan-Nordic structures. In the latter half of 2007 the Swedish market was affected by the general turbulence in the international capital markets and, as a consequence, the issuance of securities backed by assets originated in Sweden has been limited. Whether issuance levels will pick up again during 2008 remains uncertain.

While over the years many deals have been funded in the asset-backed commercial paper conduit market, there are some highlights in the public term market:

- JUNO (Eclipse 2007-2) (June 2007) – this was a synthetic securitisation of 17 commercial mortgage-backed loans originated by Barclays Bank plc. The largest portfolio consisted of loans backed by security over 171 properties in Sweden.
- Scandinavian Consumer Loans (July 2006) – this was a term securitisation of Swedish unsecured consumer loans originated by Nordax Finans. It was the first deal of its kind in the Nordic region.
- Akero Multifamily Housing 1 (May 2005) – this was a securitisation of two term loans advanced to Akelius Fastigheter secured by a portfolio of residential multi-family properties.

- Windermere III and VII (April 2004 and May 2006) – Windermere III was the first Swedish true sale commercial mortgage-backed securities transaction, backed by a portfolio of Swedish office, retail and warehouse properties. Windermere VII featured mortgage loans backed by properties located in many European jurisdictions, including Sweden.
- Midgaard Finance (March 2004) – this deal financed the sale and leaseback of the Nordea Group's head offices in Sweden, Norway and Finland. The transaction was the first of its kind in the Nordic region.
- Framtiden Public Housing Finance 1 to 5 (most recent deal in September 2004) – these securitisations of commercial mortgage loans to municipal housing companies were the first to use a Swedish SPV (on the balance sheet of the City of Gothenburg).
- Balken Finans Sweden (December 2003) – this true-sale securitisation was backed by sub-prime single and multi-family mortgages originated by Swedish state-owned Venantius. It was the first to use a Swedish orphan SPV under the 2001 exemption legislation.
- SRM Investment 1 to 3 (most recent deal in August 2003) – these securitisations included loans originated by SBAB, the Swedish National Housing Corporation. The first deal was backed by single-family mortgages. The second and third transactions were innovative in that they featured new asset classes: tenant-owner loans and loans to housing cooperatives.

In 2006 Sweden saw its first issuance of covered bonds under the new Swedish legal framework. Nordea Hypotek, The Swedish Covered Bond Corporation, Stadshypotek, Länsförsäkringar Hypotek, SEB BoLån and Landshypotek have all established covered bond programmes. Other mortgage lenders, such as Swedbank, are expected to follow suit during 2008.

This chapter highlights some of the legal issues that arise in Swedish securitisations and outlines the Swedish regime for covered bonds.

Securitisation

Transfer of assets – true sale

For legal purposes, the term 'true sale' is used to describe a sale that removes and isolates an asset from the seller so that the seller and its creditors (or insolvency officials) will be unable to recover the asset in the case of insolvency proceedings involving the seller.

To achieve a true sale of a negotiable (bearer) debt instrument, the general rule is that the instrument must be physically transferred from the seller to the purchaser. Although not strictly a perfection requirement, the debtor under a negotiable debt instrument is also normally notified of the sale to ensure that payments are not made to the seller and to comply with regulatory requirements. Swedish residential mortgages and unsecured consumer loans tend to take the form of negotiable debt instruments. Where the seller of such instruments is a credit institution, a true sale can be achieved without the possession of the negotiable debt instrument being transferred. This simplifies continued servicing by the originator.

Most other types of financial asset (eg, trade, credit card or lease receivables) are non-negotiable claims whose transfer is perfected by notifying the debtor of the transfer. The notice should state that the claim has been sold and that any future payments should be made to the purchaser. The seller, or the seller and the purchaser jointly, should notify the debtor. Following the sale the seller should be precluded from collecting the claim in its own name or agreeing to any amendment of the claim without the purchaser's consent. Nonetheless, mechanics allowing for continued servicing and collection by the seller have been developed.

Re-characterisation

Under Swedish law an assignment may be re-characterised as being made for the purposes of providing security rather than transferring ownership.

The traditional argument for such a re-characterisation is based on a substance over form reasoning: if the purpose of an assignment is to create a security interest rather than to transfer ownership, the assignment should be characterised as a secured loan. The allocation of the economic risks and rewards associated with the claim, including the credit risk and interest rate risk, will be taken into account. However, it could be argued that it is more relevant to focus on whether:

- the seller has a right to request that the claim be re-transferred to it (and, consequently, the purchaser is prevented from disposing of the claim); and
- whether, upon the bankruptcy of the purchaser, the claim would form part of its bankruptcy estate or would rather be considered as remaining under the ownership of the seller.

The means of perfecting an assignment are generally the same whether the assignment is characterised as an outright sale or a secured loan. However, a re-characterisation would be of importance from a tax and accounting point of view, as well as in the event of the seller's insolvency. Further, if an assignment is characterised as a secured loan, rules in respect of pledges may apply as between the seller and the purchaser, and the purchaser may owe certain fiduciary duties to the seller in respect of the assigned claim. However, most such duties could be contracted out of in the assignment agreement.

Seller's insolvency and rescission

Where there is a perfected sale, the seller's insolvency official will be unable to prevent the purchaser from collecting, transferring or exercising ownership rights over the claim. If an assignment of a claim constitutes a secured loan, the claim will form part of the seller's bankruptcy estate and the purchaser's rights will merely be a priority right to the proceeds from the sale or collection of the claim. The purchaser will typically be entitled to foreclose the security after a certain period unless the insolvency official opts to redeem the claim before such sale.

In any securitisation involving a Swedish seller, the grounds for rescission under the Bankruptcy Act must be borne in mind. A transaction by which one creditor has been given undue preference, or by which the debtor's assets have been unduly withheld from the creditors or the debts have been unduly increased, may be rescinded in certain circumstances. Further, there are a number of specific grounds for rescission, including:

- the transfer of assets at an undervalue;
- the payment of debts other than by customary means of payment, prematurely or in an amount which has a material adverse effect on the financial position of the debtor; and
- the provision of perfected security which was not provided for at the time when the debt arose.

The hardening periods vary from three months to five years (longer periods apply to transactions between related parties).

Regulatory issues

Swedish law stipulates that a company conducting 'financing business' in Sweden is required to hold a licence and thus be subject to capital adequacy and other regulatory requirements. A company acquiring claims and raising repayable funds from the public, such as a typical purchaser in a securitisation, will be deemed to be conducting financing business. Most Swedish securitisations have featured offshore SPVs. While it could be argued that an offshore purchaser's ownership, collection and enforcement of Swedish claims should constitute business in Sweden and thus be subject to the licensing requirement, to date the Swedish Financial Supervisory Authority (FSA) has not required such companies to be licensed. Nonetheless, this issue should be cleared with the FSA.

There is a licensing exemption for SPVs acquiring claims a limited number of times (no more than three to five times) where the financing is not raised from the general public on a continuous basis. Thus, the exemption would not apply to revolving purchases of claims with short maturities, which are financed by continuous issuances of short-term paper.

For securitisations involving consumer credits, the Consumer Credit Act will apply. It stipulates rules on the granting of credits, interest rate changes, credit scoring, charges, pre-payments, marketing and information. The FSA has also issued specific guidelines regarding the information to be provided to consumer debtors in connection with securitisations.

Originators under the supervision of the FSA must comply with certain 'clean break' criteria to benefit from regulatory capital relief. The FSA has updated its criteria to reflect Basel II and the EU Banking Consolidation Directive (2006/48/EC).

The EU Prospectus Directive (2003/71/EC) was implemented into Swedish law on January 1 2006. Under the new legislation, all rules concerning prospectuses are brought together in the Financial Instruments Trading Act. The prospectus rules contain a number of statutory exemptions, including:

- offers to qualified investors;
- offers to fewer than 100 persons per member state;
- offers of securities with a minimum denomination or total consideration payable of less than €50,000; and
- offers of securities with a total consideration of not more than €1 million calculated over a period of 12 months.

The statutory exemptions are expected to facilitate private placements in Sweden since the exemptions are wider in scope than under the previous regime.

The EU Transparency Directive (2004/109/EC) was implemented into Swedish law on July 1 2007. Under the new legislation, all Swedish issuers must select a home member state and new rules have been established for the publication of mandatory information. As a consequence of the new legislation, the Stockholm Stock Exchange listing contract has also been changed to reflect the rules on publication of information.

Personal data and bank confidentiality

The Personal Data Act applies to all processing of personal data relating directly or indirectly to private individuals. In general, the controller of personal data must notify the Data Inspection Board before commencing the processing of personal data, and individuals whose personal data is being processed should be informed about the processing. In certain circumstances their consent will be required. The transfer of personal data to a third party (eg, a purchaser of consumer receivables) constitutes processing of data. There is a general prohibition against transfers of personal data to countries outside the European Economic Area which do not offer an adequate level of protection for personal data.

Swedish credit institutions have a duty of confidentiality under which a customer's relationship to the institution may not be unduly disclosed. This applies to both private individuals and corporate customers and must be borne in mind if the originator is a credit institution.

Tax issues

There is no withholding tax on interest or other payments on debts under domestic Swedish tax law. Further, there is no stamp duty or other documentary tax on the sale of financial assets.

Value added tax (VAT) is imposed on sales of goods and services. The Swedish VAT regime is based on the Sixth VAT Directive (77/3888/EEC). Collection agent services are taxable in Sweden if they are supplied within the country. The sale of financial assets is generally exempt from VAT.

An offshore SPV would be liable to pay income tax in Sweden only if it is considered to have a permanent establishment in Sweden. The definition of a 'permanent establishment' in Swedish domestic tax law is based on the Organisation for Economic Cooperation and Development Model Convention. In general, if a Swedish seller is considered a dependent agent of the purchaser, the purchaser is regarded as having a permanent establishment in Sweden (and is thus subject to Swedish corporate tax at 28 per cent of net profits). Normally, a securitisation transaction can be structured so as to avoid an offshore purchaser having a permanent establishment in Sweden.

Covered bonds

Legislation on covered bonds entered into force in Sweden on July 1 2004, introducing a new method of financing for Swedish financial institutions. The new regime enables Swedish banks and credit market companies to issue full-recourse debt instruments, secured against a pool of mortgage assets and/or public sector claims. While a covered bond transaction should be simpler to execute than a securitisation, it will not result in regulatory capital relief for the issuer as in the case of a true-sale securitisation.

Authorised issuers

Before issuing covered bonds the issuer must seek permission from the FSA. One key condition for the granting of such permission is that any (unsecured) bonds previously issued for the purposes of financing similar assets must be transformed into covered bonds (or otherwise dealt with so that existing bondholders are not discriminated against). Furthermore, the institution must produce an audited financial plan showing that its financial condition is such that the interests of its other creditors will not be jeopardised.

Cover pool assets

The cover pool may consist of mortgage loans and loans to particularly strong public sector debtors (eg, the Swedish state, Swedish municipalities, certain foreign states and central banks). The eligibility criteria for mortgage loans include each property being located within the European Economic Area and the loan-to-value ratio not exceeding:

- 75 per cent for residential properties;
- 70 per cent for agricultural properties; and
- 60 per cent for commercial properties.

In addition, the portion of commercial mortgage loans must not exceed 10 per cent of the total cover pool.

The cover pool may also include a limited portion (generally no more than 20 per cent) of additional or substitute collateral in the form of cash and certain gilt-edged securities (ie, liquid assets with zero risk-weighting).

To ensure that any hedging arrangements related to the bonds survive the bankruptcy of the issuer, such arrangements are also included in the cover pool. Consequently, it is not intended that the issuer's insolvency should trigger an event of default under the hedging documentation (as would be the case under a standard International Swaps and Derivatives Association agreement).

Matching

The nominal value of the cover pool must always exceed the amount outstanding under the covered bonds. The legislation does not prescribe a specific level of over-collateralisation (but rating agencies may well do so). A special provision applies regarding the determination of the nominal value for mortgage loans in the cover pool. If the market value of the property securing such a loan has dropped materially (by some 15 per cent or more), only a reduced portion of that loan may be included in the value calculation.

The issuer must ensure that the terms of the loans and other assets of the cover pool (including any hedging instruments) match the terms of the covered bonds as regards interest rates, interest periods and currencies. These matching criteria are deemed to have been met if the nominal present value of the cover pool (including any hedging instruments) is greater than the present value of the issuer's liabilities under the covered bonds and under any hedging instruments.

The issuer must also ensure that the cover pool generates a cash flow sufficient to meet the issuer's continuing payment obligations to the bondholders and to any hedging counterparties.

Registration and substitution

The issuer must keep an up-to-date and detailed cover register, listing the covered bonds, the assets of the cover pool and any hedging arrangements. The register must at all times set out the nominal values of the covered bonds and the assets of the cover pool, as well as information regarding maturities and interest rates. The issuer may supplement and substitute assets in the cover pool provided that the pool continues to meet both the matching requirements and any other criteria.

Insolvency aspects

In the event of an issuer's insolvency, the bondholders and hedging counterparties enjoy a first priority right over the cover assets as entered in the cover register. In general, the priority also extends to cash generated by the cover pool before and after the petition for bankruptcy.

Provided that the cover pool continues to meet the qualitative requirements, the bankruptcy will not trigger a suspension of payments to the bondholders. The bankruptcy administrator will continue to manage the cover pool separately from the estate and make scheduled payments to the covered creditors. However, where the cover pool is of insufficient size or quality, the loan outstanding under the covered bonds will be immediately accelerated. The cover pool will then be liquidated and the covered creditors will enjoy a first priority right to the proceeds. To the extent that the claims of the covered creditors are not satisfied out of the proceeds, such claims will compete with the claims of the issuer's unsecured creditors. Certain costs attributable to the bankruptcy and some costs incurred by the bankruptcy administrator will rank ahead of the covered creditors.

Supervision and regulation

The FSA will supervise the issuers and their compliance with the new legislation. For each issuer, the FSA will also appoint an independent trustee who will inspect the cover register and ensure that the matching and valuation principles are observed. The trustee will be paid by the issuer.

Investor issues

The Swedish covered bonds regime has been designed to meet applicable European investor and European Central Bank requirements. Thus, for example, it is intended that the covered bonds should qualify for 10 per cent capital risk-weighting and that undertakings for collective investments in transferable securities funds should be allowed to invest up to 25 per cent of their assets in covered bonds issued by a single issuer.

Rating considerations

Standard & Poor's, Moody's and Fitch Ratings have all announced that in principle Swedish covered bonds will be eligible for the highest possible credit rating. To date, all Swedish covered bonds issued have been assigned AAA/Aaa ratings.