

# New Belgian legislative framework for securitisations

**LAGA**



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# New Belgian legislative framework for securitisations

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**T**he Belgian securitisation market is facing a new legislative framework resulting from (i) the Act of 20 July 2004 implementing the EU UCITS Directives and (ii) a new draft Act – currently being submitted to Parliament – implementing the EU Prospectus Directive which will, among others, amend the former Act. While “public” securitisation structures have effectively come to a standstill in Belgium, these recent legislative developments are expected to boost ‘institutional/private’ structures.

Generally, the securitisation of debt receivables in Belgium often involves a “company for investment in receivables” (*société d’investissement en créances* (SIC)) as purchasing and issuing SPV. One of the major benefits of using a SIC is that its use should not create any material tax burden (in terms of stamp duty, corporation tax, withholding tax and VAT). By law, a SIC is prohibited from engaging in any other kind of activity than the acquisition and financing of receivables. The traditional distinction is between a SIC which offers securities to the general public (public SIC) and a SIC which only offers securities to specific categories of institutional or professional investors (institutional SIC): whereas a public SIC is subject to the regulatory supervision of the Belgian Banking, Finance and Insurance Commission (BFIC) and its establishment needs the BFIC’s approval, its institutional counterpart is only subject to a minimum of regulation.

There is no regulatory requirement obliging Belgian originators to use a Belgian SIC. For trade receivables and other “non-regulated” assets such as corporate loans and commercial mortgages, offshore vehicles can be, and are, frequently used (such choice being typically determined by the tax analysis). Securitisation of “regulated” receivables however is only feasible by

using a SIC since (a) for mortgage receivables, the assignment to a SIC does not need to be recorded in the land register to be effective and therefore benefits from an exemption of the relatively high stamp and mortgage duties on the secured amount and other costs; and (b) for consumer credit receivables, the transfer is statutorily only allowed to a limited number of institutions, including SICs.

### UCITS Act

On 9 December 2005, the final provisions of the new law of 20 July 2004 on certain forms of collective management of investment portfolios (UCITS Act) (already announced in last year's edition) entered into effect. This happened to coincide with the closing of the "B-TRA 2005-I" transaction involving the €500 million securitisation by the Belgian Ministry of Finance of defaulted tax receivables, being the last deal applying an "old-style" public SIC. The UCITS Act implements a number of EU Directives regulating the business of undertakings for collective investment in transferable securities (UCITS)(ie Directives 2001/107/EC and 2001/108/EC). Even though the Directives only deal with UCITS, the Belgian law has extended the application of several provisions to SICs.

### Structural enhancements for public and institutional SICs

The UCITS Act significantly enhanced the SICs bankruptcy remoteness by confirming that the insolvency of one of its ringfenced portfolios of assets ("a compartment") does not lead to the insolvency of another compartment of the same SIC. In addition, a creditor of a SIC is validly restricted in its rights to sue for dissolution, liquidation or any type of insolvency proceeding (so-called "non-petition" clauses). Finally, special legislation was introduced allowing a SIC to appoint one or more representative(s) of the noteholders to perform a broadly similar role as a typical English trustee within a Belgian law context.

### More regulatory requirements for public SICs

The UCITS Act introduced important changes with

respect to the management of public SICs. The main new requirement is that each public SIC must either (i) be set up to manage itself autonomously or (ii) appoint a management company that is licensed by the BFIC to manage public SICs. For standard securitisation transactions, "autonomous" management is not feasible since the SIC is a special purpose company without staff. Therefore, the only realistic option is to operate through a licensed management company.

In order to obtain a licence as a management company, a company must have a management, administrative and technical structure which the BFIC considers to be appropriate for managing the assets of a SIC. A management company may, under certain conditions, outsource one or more of its tasks, one of the conditions being that the sub-manager is also under the prudential supervision of the BFIC, has an appropriate organisation and is established in Belgium. The servicing of the assets of a public SIC is also deemed to constitute a management task and is therefore, in principle, subject to the same outsourcing requirements. However in the event the originator is appointed as servicer, the outsourcing requirements are not applicable.

Aside from the new rules on management, a public SIC will continue to be subject to the existing regulatory requirements of control and supervision, notably:

- (a) the appointment of a statutory auditor;
- (b) the appointment of a custodian (typically a Belgian credit institution) responsible for the safekeeping of cash balances and securities;
- (c) the appointment of a supervision company (who monitors the sale and repayment of the securities issued by the SIC and the evolution of the cashflows and the risk profile of the portfolio of receivables in accordance with the financial plan);
- (d) the appointment of a security agent (who acts at the appointment and in the interest of the noteholders);
- (e) the appointment of one or more rating agencies; and

- (f) for each public issue, the publication of an offering circular approved by the BFIC (and reporting thereafter on an annual, semi-annual and quarterly basis).

Given that at the moment no management company has obtained a licence from the BFIC, transactions involving a public SIC are for the time being de facto impossible.

#### Limited regulatory requirements for institutional SICs

The UCITS Act introduced few changes for institutional SICs. Emphasis was put on the SIC's obligation to manage its assets on the basis of the principle of risk diversification and in the exclusive interest of the investors. It may hence be questioned whether an institutional SIC is still able to set up a single asset transaction.

As a condition for qualifying as an institutional SIC, the SIC must at all times obtain its entire funding (both equity and debt) from a limitative list of so-called "institutional or professional investors" (see below). The only applicable exception newly introduced by the UCITS Act related to the case where a non-institutional originator providing funds as actual "credit enhancement" ie funds provided to the SIC to protect the investors against the default risks related to the receivables.

An institutional SIC must be duly registered with the Federal Ministry of Finance prior to starting up its activities. However, this does not include any active upfront control or continuous monitoring and hence (unlike the BFIC for a public SIC) there is still no official authority "rubberstamping" that the criteria for an institutional SIC are met.

#### Prospectus Act

Notable disadvantages of using an institutional SIC left unresolved by the UCITS Law were that (i) the list of so-called "institutional or professional investors" remained quite limited and certain categories referred to therein subject to interpretation difficulties, (ii) regardless of the

structural arrangements ensuring that investors are at all times solely institutionals, the institutional character could be at risk (with significant adverse tax-consequences resulting therefrom) if certain securities at any time happen to be sold to non-institutionals, and (iii) the securities issued by a SIC are not liquid since they may not be listed on a regulated exchange in Belgium or, arguably, even abroad. The Belgian Government at the start of 2006 decided, as part of the draft Act "on the public offer of investment instruments (*instruments de placement*) and the admission of investment instruments to trading on a regulated exchange" (implementing the EU Prospectus Directive 2003/71/EC) (the Prospectus Act), to address these issues by introducing a number of important modifications to the UCITS Act. The Prospectus Act is expected to be adopted and published by the summer. Existing institutional SIC structures will be grandfathered. The most important changes are twofold.

#### Broader scope of institutional investor base

The principle remains that a SIC is considered to be "institutional" if and when it attracts its funding solely from institutional investors. For this purpose the list of qualifying entities has now been expanded:

- (a) first, the existing list of "institutional investors" remains generally speaking in place, including the Kingdom of Belgium and the local Regions and Communities; the Central European Bank, the Belgian National Bank, the *Fonds des Rentes*, the *Fonds de protection de depots et des instruments financiers* and the *Caisse des depots et consignations*; credit institutions registered in Belgium; Belgian and foreign regulated investment companies conducting activities in Belgium; collective investment institutions; insurance and reinsurance companies; capitalisation companies; co-ordination centres; companies meeting two of at least three criteria (ie employee base, turnover and/or revenues); some special foreign investment vehicles marketing interests to professional investors only;

and other foreign institutions and companies considered as professional or institutional investors under their national laws or in accordance with local financial market practices (which interestingly enough, may now include a wide range of entities or even individuals which are considered in such local market to be “qualified” investors in application of the Prospectus Directive as locally implemented );

- (b) second, institutional investors are now also Belgian or foreign entities whose “sole” corporate purpose is investing in “mainly” financial instruments other than securities issued by collective investment institutions; and
- (c) third, Belgian or foreign entities whose “main activity” (*activité principale*) is the investment in securities issued by collective investment institutions or in “securitisation structures” are considered to be institutional provided they attract their financing (i) if in Belgium, solely from institutionals referred to in the new list of the Prospectus Act and/or (ii) of abroad, from any investors without limitation. In other words, the interpretation difficulty as to whether such (often conduit) entities act on their behalf or on behalf of their underlying investors should now be resolved in that they are considered to act in their own name and on their own behalf albeit that Belgian underlying investors should qualify as institutional investors.

#### **Structural guarantees as a necessary and sufficient condition**

As of the entry into effect of the Prospectus Act, if either securities issued by a SIC are admitted to trading on an organised market accessible to the public or third parties at any time trade such securities to entities that do not qualify as institutional investors, such course of action will no longer jeopardise the institutional character of the SIC provided that:

- (a) at the time of structuring the transaction, the SIC has taken all “appropriate” measures to guarantee

that the securities fall in the hands of non-institutional investors; and

- (b) throughout the term of the transaction, the SIC itself (and any entities acting on its behalf) will not act (or omit to act) in such a way that it contributed to or increased the risk that its securities would be sold to non-institutional investors.

A Royal Decree will clarify the criteria to be met in order to fulfil the requirement that all appropriate measures are duly taken. The advanced draft text currently circulating provides for the following conditions to be cumulatively met:

- (a) the terms and conditions of the securities issued by the SIC, its articles of association and management regulation, as well as any other document relating to the issuance, the subscription or the trading of such securities should explicitly provide that the securities may only be subscribed, purchased or held by institutional investors;
- (b) the bearer securities or in case of registered securities, the certificates confirming the inscription should indicate that the securities may only be purchased or held by institutionals;
- (c) the listing prospectus should confirm the same;
- (d) any communication made by the SIC in any form should confirm the same;
- (e) the securities should be in registered form; and/or the subscription value of a single note (or other security) issued by the SIC should be at least €250,000; and/or each investor subscribing to or purchasing any security confirms formally in writing to the SIC that he qualifies as institutional investor within the meaning of the Prospectus Act and undertakes not to sell its security(ies) to an entity other than one that has likewise made this double confirmation to the SIC;
- (f) the SIC shall refrain from paying out any dividend or interest relating to these securities of which it finds out that they are not held by an institutional investor; and

- (g) the SIC shall refuse to inscribe an investor in the relevant security registry if at the time of issuance, it finds out that such entity does not qualify as institutional.

This new mechanism will significantly enhance legal certainty of institutional structures in that it enables an institutional SIC to provide for the necessary legal “belt-and-braces” at the time of issuance and provided it continuously acts diligently throughout the transaction, not to risk losing its institutional status. Aside therefrom, the regulatory requirements and constraints

remain reduced to a minimum because there is no need to protect the general investor public (and hence no requirement for supervision by the BFIC).

The Belgian Government will apply the proverbial “proof of the pudding” as it announced setting up a VAT receivable securitisation by making use of the new-style institutional structure. Likewise, a number of private institutions have been waiting for the outcome hereof to start putting mortgage and consumer credit structures in place anticipating the use of the new institutional SIC. Others are likely to follow in the course of the year.

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