

# New Belgian securitisation framework at work

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The Belgian securitisation market has become acquainted with the new legislative framework resulting from the Act of 20 July 2004 implementing the EU Undertakings for Collective Investments in Transferable Securities (UCITS) Directives and the Act of 16 June 2006 implementing the EU Prospectus Directive, which amends the former prospectus legislation. While public securitisation structures have effectively come to a standstill in Belgium, these recent legislative developments have increased securitisations in respect of institutional/private structures.

The fourth quarter of 2006 saw a number of notable operations using the new institutional *société d'investissement en créances* (SIC) with listed securities. Following on from a transaction at the end of 2005 involving the last old-style public securitisation vehicle, the federal government set up the B-TRA 2006-I securitisation relating to a portfolio of non-performing value added tax and income tax receivables. The transaction involved the issue of floating rate notes (with each class of notes represented by a single global bearer note deposited with the Belgian National Bank to be converted into dematerialised notes on January 1 2008) with an aggregate nominal value of €715 million and listed on Euronext Brussels. The quality of the data relating to the historical recovery of the claims and the implementation of the collection and recovery procedures will further determine the success of these transactions.

In addition, Belgian mortgage and consumer credit provider Krefima set up the Diamond Mortgage Finance 2006 securitisation, making use of an institutional structure involving the sale of a portfolio of mortgage receivables and the issue of floating-rate notes (in the form of dematerialised *certificats*

*de trésorerie* held in the X/N securities clearing system operated by the Belgian National Bank) with an aggregate nominal value of approximately €600 million and listed on Euronext Brussels.

Furthermore, Delta Lloyd Bank Belgium set up the B-Arena Compartment 1 securitisation, involving the sale of a portfolio of regulated receivables and the issuance of floating-rate notes (with each class of notes represented by a single global bearer note deposited with the Belgian National Bank, to be converted into dematerialised notes on January 1 2008) with an aggregate nominal value of €992 and listed on Euronext Brussels.

Another notable development is the increasing interest for real estate finance origination being refinanced by means of commercial mortgage-backed securities (CMBS). The year 2006 saw not only Belgian banks such as Fortis Bank, but also foreign banks such as Barclays Bank originating loans structured in view of CMBS refinancing. This pace is continuing in 2007 with, for example, Barclays' Eclips-10 (structured as a collateralised debt obligation) including, among others, five Belgian commercial loans.

In addition to residential mortgage-backed securities, commercial mortgage-backed securities and strong collateralised debt obligation activity, various Belgian banks have structured undisclosed trade and other receivables transactions through their conduits for corporate clients. Certain large Belgian banks, partly as a result of Basel II, are increasingly considering removing trade financing loans from their books by including them in trade receivable securitisations programmes.

### Regulatory framework at work

The securitisation of debt receivables in Belgium often involves an SIC as the purchasing and issuing special purpose vehicle. One of the major benefits of an SIC is that its use should not create any material tax burden (in terms of stamp duty, corporation tax, withholding tax and value added tax). The traditional distinction is between an SIC offering securities to the general public and an SIC offering securities only to specific categories of institutional or professional investors:

whereas a public SIC is subject to the regulatory supervision of the Belgian Banking, Finance and Insurance Commission and its establishment needs the commission's approval, its institutional counterpart is subject only to minimum regulation.

There is no regulatory requirement obliging Belgian originators to use a Belgian SIC. For trade receivables and other non-regulated assets (eg, corporate loans and commercial mortgages), offshore vehicles can be and are frequently used. Securitisation of regulated receivables, however, is feasible only by using an SIC since:

- for mortgage receivables, the assignment to an SIC need not 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
- for consumer credit receivables, the transfer is statutorily allowed only to a limited number of institutions, including SICs.

### UCITS Act

The Law of 20 July 2004 on Certain Forms of Collective Management of Investment Portfolios (the UCITS Act) entered into full effect at the end of 2005.

The UCITS Act significantly enhanced the SIC's bankruptcy remoteness by statutorily confirming the ring-fencing of its other compartments in case of the insolvency of one compartment. In addition, non-petition clauses are confirmed to be effective. Special legislation was introduced to allow an SIC to appoint one or more representatives of the noteholders to perform a broadly similar role as a typical UK trustee within a Belgian law context.

The UCITS Act introduced important changes with respect to the management of public SICs. The key new requirement is that each public SIC must either be set up to manage itself autonomously or appoint a management company that is licensed by the commission 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. Since the enactment of the UCITS Act, Belgium has seen no structures involving new-style public vehicles.

In order to obtain a licence as a management company, a company must have a management, administrative and technical structure which the commission considers to be appropriate for managing the assets of an SIC. A management company may, under certain conditions, outsource one or more of its tasks provided that the sub-manager is also under the prudential supervision of the commission, 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 that the originator is appointed as servicer, the outsourcing requirements are inapplicable.

Apart from the new management rules, a public SIC continues to be subject to the existing regulatory requirements of control and supervision, notably the requirement to appoint:

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

In addition, for each public issue the SIC must publish an offering circular approved by the commission (and reporting thereafter on an annual, semi-annual and quarterly basis).

The UCITS Act introduced few changes for institutional SICs. Emphasis is 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. Thus, the question of whether an institutional SIC is still able to set up a single asset transaction arises.

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 limited list of institutional or professional investors. The only applicable exception introduced by the UCITS Act relates to the case where a non-institutional originator provides funds as actual 'credit enhancement' (ie, funds provided to the SIC to protect the investors against the default risks related to the receivables). Between May and September 2006, before the execution decree of the relevant provisions of the UCITS Act entered into force, the commission used its power to approve a similar derogation from the obligation to obtain funding exclusively from institutional investors in respect of funding provided as credit enhancement.

An institutional SIC must be duly registered with the federal Ministry of Finance before starting its activities. However, this does not include any active upfront control or continuous monitoring and thus there is still no official authority checking that the criteria for an institutional SIC are met.

### Prospectus Act

Notable disadvantages of institutional SICs left unresolved by the UCITS Act were as follows:

- The list of institutional or professional investors remained quite limited and certain categories referred to therein remained subject to interpretation difficulties;
- Regardless of the structural arrangements ensuring that investors are at all times solely institutional, the institutional character could be at risk if certain securities happen to be sold to non-institutional investors; and

- The securities issued by an SIC were not liquid since they could not be listed on a regulated exchange in Belgium or, arguably, even abroad.

At the start of 2006 the government decided to address these issues as part of the drafting of the Act of June 16 2006 implementing the EU Prospectus Directive. There were two key changes.

First, the principle remains that an 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 as follows:

- The existing list of institutional investors generally remains in place, including:
  - credit institutions registered in Belgium;
  - Belgian and foreign regulated investment conducting activities in Belgium;
  - collective investment institutions and their management companies; 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 may now include a wide range of entities or even individuals that are to be qualified investors under the Prospectus Directive).
- Also classed as institutional investors are Belgian or foreign entities whose sole corporate purpose is investing in financial instruments issued by collective investment institutions.
- Belgian or foreign entities whose main activity is investment in securities issued by collective investment institutions or in securitisation structures are considered to be institutional provided they attract their financing solely from institutional investors as listed in the Prospectus Act if in Belgium or, if abroad, from any investors. In other words, the interpretative difficulty as to whether such 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, although underlying Belgian investors should qualify as institutional investors.

- The concept of 'institutional investors' was further determined by the Royal Decree of September 26 2006 to include some entities that do not meet the criteria but expressly apply for the status of institutional investor. If the conditions of the decree are met, they are registered in the list of institutional investors kept by the commission and published on its website.

Second, since the coming into force of the Prospectus Act, if securities issued by an SIC are admitted to trading on an organised market accessible to the public, or if third parties trade such securities to entities that do not qualify as institutional investors, such action will no longer jeopardise the institutional character of the SIC, provided that:

- at the time of structuring the transaction, the SIC has taken all appropriate measures to guarantee that the securities fall into the hands of non-institutional investors; and
- throughout the term of the transaction, the SIC and any entities acting on its behalf does not act (or fail to act) in such a way that it contributes to or increases the risk that its securities would be sold to non-institutional investors.

The Royal Decree of September 15 2006 sets out the criteria to be met in order to fulfil the requirement that all appropriate measures are duly taken. The following conditions must be cumulatively met:

- The terms and conditions of the securities issued by the SIC, its articles of association and management regulation, as well as any other documents relating to the issuance, subscription or trading of such securities, must explicitly provide that the securities may be

subscribed, acquired or held by institutional investors only.

- The bearer securities or, in case of registered securities, the register of such securities and the certificates confirming the inscription in the register must indicate that the securities may be subscribed, acquired or held by institutional investors only.
- The listing prospectus and any communication made by the SIC in any form should confirm this.
- 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 acquiring any such security must confirm in writing to the SIC that he or she qualifies as an institutional investor within the meaning of the Prospectus Act and undertakes not to transfer security(ies) issued by the SIC to an entity other than one that has made this double confirmation to the SIC.
- The SIC shall refrain from paying out any dividend or interest relating to these securities discovered not to be held by an institutional investor.
- With regard to registered securities, the SIC shall refuse to inscribe an investor in the relevant security register if it discovers that such an investor does not qualify as institutional investor.
- The two preceding conditions shall be mentioned in the issuance conditions, management regulation or articles of association and listing prospectus, as well as in any other documents relating to the issuance, trading or listing of securities issued by the SIC.

This new mechanism has significantly enhanced legal certainty for institutional structures, ensuring a liquid trading of the notes issued. In addition, the regulatory requirements and constraints remain reduced to a minimum because there is no need to protect the general investor public (and thus no requirement for supervision by the commission).

### Other legal developments

With securitisation transactions often including cross-border aspects, the introduction of the Code of Conflict of Laws on October 1 2004 resolved a number of issues. However, at the same time it has left a number of frequently asked queries unanswered. For example, the requirements for effectiveness of the transfer of receivables (or the granting of rights *in rem*, such as pledges over such receivables) in regard to third parties are confirmed to be determined by the law of the habitual residence of the transferring party (or the main establishment of corporations) at the moment of the transfer of such receivables or the granting of the rights thereon. This implies that the law chosen by the parties will govern the validity and binding nature of the transfer/pledge, but another set of rules may need to be followed at the same time to ensure that the transfer/pledge is effective against all other parties (including the bankruptcy trustee of the transferor/pledge at the time of an insolvency event). As bank accounts and credit are commonly considered to be receivables, the granting by, for example, a US bank of a Belgian law pledge on an account held in Belgium would need to comply with US perfection requirements. This rule has been strongly criticised and is likely to be amended.

Another issue that remains is whether future receivables arising from existing contracts can be effectively transferred by way of an (undisclosed) assignment. This is particularly relevant for trade receivable securitisations involving automatic rollover mechanisms.

As with many other civil law jurisdictions, Belgian law considers security rights to be accessory to the underlying debt. Where the equivalent of a security trust is needed for a loan origination designed to be refinanced, a parallel debt or covenant to pay mechanism may achieve the same result.

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