

At a glance

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Securitisation in Bulgaria: Some Legal Issues

Overview

Mayer, Brown, Rowe & Maw LLP has already advised on a securitisation of Bulgarian small and medium enterprise loans.

Effective 1st September 2007, Bulgarian banks must increase their deposits with the National Bank so that mandatory capital reserves amount to 12 % instead of the current 8 %. It is likely this will lead to securitisations during the course of 2007.

This trend will be further facilitated by the recent implementation of the European Union directive for capital adequacy into Bulgarian law effective 1st January 2007. This new regulation, along with the fast-growing consumer and mortgage loan portfolios, will cause banks to seek capital relief and additional lower-cost sources of funding, including off-shore true sale and synthetic securitisation transactions.

Furthermore, by virtue of explicitly recognised securitisation for capital relief purposes by Ordinance 8 of the Bulgarian National Bank, it is likely that securitisation will become an effective balance management and funding method in Bulgaria.

Legal considerations

This overview focuses on highlighting the most relevant legal issues when structuring off-shore true sale securitisations, which have already been successfully accomplished.

Outside the scope of this overview is the regime of on-shore securitisation transactions pursuant to the Special Investment Purpose Companies Act ("**SIPCA**") in force since 2004. In brief, SIPCA governs publicly listed receivables and real estate securitisations with originators that are only Bulgarian corporations and Bulgarian issuers, the so-called Special Investment Purposes Companies ("**SIPC**"), which have to be licensed by the Securities Commission. The SIPCA restricts the use of SIPC for the purposes of cross-border transactions.

(1) Choice of law

Under Bulgarian law, parties to a contract are free to choose the law which will govern their contractual relationship, even in the case where both parties are Bulgarian. Following the Rome Treaty (which is incorporated into the Bulgarian International Private

Law Act) however, Bulgarian law stipulates in such cases that there cannot be any derogation from the mandatory rules of the Bulgarian substantive law. Thus, the choice of law provisions are usually utilised only by counterparties in different jurisdictions.

When choosing foreign law to determine an assignment agreement, if the underlying contract is governed by Bulgarian law, Bulgarian law will also govern issues of assignability, set-off and discharge by the debtor in a securitisation contract as well as the relationship between the assignee and the debtor.

(2) True sale

An assignment is valid between the assignor (in a securitisation contract, the originator) and assignee (in a securitisation contract, the SPV). It is valid even when a contractual prohibition on assignment is included within the underlying receivables contract provided that the debtor has given its prior consent. It must be stressed that an assignment is null and void when it occurs despite a prohibition of law, for example, relating to tax receivables, mandatory social insurance contributions etc..

In general, the right of the debtor to discharge or to set-off may be excluded by notification to the debtor, prior to or after the assignment, preferably in writing,¹ with the assignor having to notify the debtor. It is assumed in practice that if the debtor has not been notified and the assignor defaults, the assignee may notify the debtor with a power of attorney from the assignor. Of course, a waiver of such notification is possible when it is explicitly agreed in the underlying receivables contract.²

It is notable that pursuant to the Consumer Loans Protection Law (CLPL) effective 1st October 2006, assignments of consumer loans are restricted other than where it is expressly agreed in the underlying credit agreements relating to consumer goods and services. Furthermore, according to the CLPL the consumer's set-off and counter-claim right cannot be waived upon assignment of the consumer loan.

A true sale is achieved when the assignment agreement is concluded "at arm's length". For the purposes of minimising challenging or re-qualification risks of the true sale, it is advisable to obtain an opinion or an evaluation by an independent certified accountant.

The receivables have to be sufficiently identifiable when assigning. Future receivables can also be assigned, e.g. using language such as "... and all future receivables which will arise under the underlying contract".

In the cases where a receivables contract is backed by rights over collateral, the rules with respect to the transfer of the related collateral must be satisfied when structuring a true sale.

(3) Transfer of collateral

Ancillary rights, e.g. mortgages and pledges, pass automatically with the assignment. Certain registration requirements must be fulfilled, however. It is advisable that the registration is carried out by the assignee, as exercise of title over the receivables and the collateral is subject to registration.

There are different registers in Bulgaria. For example, where the security type is a going concern pledge, the registration must be effected by a filing on the Register of Commercial Companies. Rights over shares of public listed companies must be registered with the Central Depository. If a patent or an intellectual property right is pledged, the Patent Office acts as the registration authority. In the case of special pledge right, e.g. over receivables or movable assets, the type of security which is commonly used in the Bulgarian banking market, the re-registration is effected with a filing on the Special Pledge Register. Mortgages are transferred after complying with a notarisation and registration with the local Land Register. In the case where a transfer of mortgage-backed receivables requires a re-registration with different local land registers, the assignee is entitled to submit the application for re-registration with one of the registries. The registrar is obliged to carry on and assure the re-registration of the new creditor's title with the respective local land register.

(4) Claw-back and "suspect periods"

Different periods of time to make use of the right to claw-back as well different "suspect periods" apply depending on whether the insolvent assignor is a bank or a corporation.

When an insolvency procedure for a corporation is commenced, the insolvency administrator may challenge certain transactions within one year of commencing the insolvency proceedings; in the case of a bank, this period is increased to two years.

The transactions which are vulnerable to challenge vary, in terms of the legal protection afforded to different types of rights and interests under Bulgarian law, and depend on whether they are "at arm's-length", are fraudulent or are conducted between affiliates etc. In relation to the different types of transactions, the "suspect periods", i.e. the periods of time within which these transactions have been conducted, vary from three months to three years for corporate insolvencies and from six months to five years for bank insolvencies prior to commencement of insolvency proceedings.

"Non-petition" clauses are not yet a proven mechanism for enhancing credit-worthiness of securitisation transactions. Although a general principle of Bulgarian civil law restricts a counterparty from giving up its rights before they arise, a "non-petition" clause would be treated as lawful due to the contractual freedom guaranteed by the Constitution.

(5) Data protection

Like most European Union and Eastern European jurisdictions, Bulgaria restricts the use and dissemination of personal data without explicit consent, e.g. of consumers. There are no data protection restrictions where legal entities are involved. The person who will use the personal data needs to be registered as a Personal Data Administrator with the Commission for Protection of Personal Data.

Further, consent may not be required where the disclosure of data is necessary for the realisation of legitimate interests. One can assume that the interests of the banks in relation to a refinancing would be covered by this regulation.

Nevertheless, where the person who will use the personal data is located outside Bulgaria, it is advisable to coordinate the "export" of any personal data with the Commission.

Pursuant to the new Consumer Protection Act which came into force on 10th June 2006, there are additional restrictions providing for further protection of consumer rights, e.g. consumer protection rules will also apply in relation to banking services.

In terms of banking secrecy under Bulgarian law, one can assume that banking secrecy rules are deemed to be complied with to the extent that the disclosure of the loan and related information does not infringe on rules regarding disclosure of information concerning the borrower's deposits and account movements. This is the case, for example, where the borrower has given its consent to the disclosure.

(6) Regulatory

Under Bulgarian law neither the purchase nor the servicing of receivables requires a license.

There are no restrictions on money transfer and currency exchange, except for certain declaration obligations and periodic reporting obligations. For example, with regard to debt owed to foreign entities, which must be reported to the Bulgarian National Bank for statistical purposes. No particular regulatory obstacles exist for Bulgarian counterparties when they participate in cross-border transactions.

(7) Taxation

The double tax treaties Bulgaria has with The Netherlands and the United Kingdom reduce the withholding tax to zero upon compliance with certain procedural requirements.

Under Bulgarian tax law, there are no stamp duties (or other taxes) when assigning receivables other than when mortgages must be registered and registration fees paid with regard to the registration of the new assignee's rights in the local Land Register.

Under Bulgarian tax law, the assignor is not obliged to charge VAT. However, if the particular transfer qualifies as factoring service, the assignee will be VAT taxable. This is the case where the assignee is a Bulgarian entity and takes the credit and collection risk for consideration, e.g. a discount in the purchase price.

The servicing of receivables is VAT taxable at a rate of 20 % when servicing is performed in Bulgaria.

¹ According to certain scholars, the right of the debtor to set-off may be excluded only by way of obtaining the debtor's consent.

² Pursuant to Bulgarian law, waiver is not a mechanism tested in practice yet. Nevertheless, such conclusion can be drawn based on the principle of contractual freedom.

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