SECURITISATION OF LOAN PORTFOLIOS IN POLAND VIA INVESTMENT FUNDS

Polish law has two regimes for the securitisation of loan portfolios generated by banks, one governed by the Banking Act and one by the Investment Funds Act. Securitisation may proceed via a special purpose company (issuing entity) or via a securitisation investment fund. In addition, special tax-driven structures involving partnerships have been designed for certain portfolios. In this paper, we only review the structures involving securitisation funds.

Key issues

INVESTMENT FUNDS ACT

The Investment Funds Act provides for closed-end securitisation investment funds (the "Securitisation Funds") that can issue registered or bearer securities called investment certificates. Investment certificates can be publicly offered and listed on a regulated market or in a multilateral trading facility (and a Securitisation Fund whose certificates meet the criteria referred to above is a "Public Securitisation Fund"). This requires the preparation and approval of a prospectus in accordance with the relevant Polish laws that implement the Prospectus Directive (Directive 2001/34/EC).

However, Securitisation Funds are typically set up as private vehicles whose certificates are offered in a private placement and will not be listed. (Such a fund is referred to as a "Private Securitisation Fund".)

FUND MANAGER

Each Securitisation Fund is managed by a Fund Manager (Towarzystwo Funduszy Inwestycyjnych, TFI), but a Fund Manager may manage more than one Securitisation Fund and may be the manager of other kinds of funds under the Investment Funds Act. A Fund Manager must be a Polish joint stock company (the equivalent of a PLC in the UK, an SA in France or Spain or an AG in Germany), with a minimum capital of the PLN equivalent of €125,000. If the scope of the Fund Manager's activity is extended by other regulated activities[1] , the initial required capital may increase up to the PLN equivalent of €730,000.

[1] Other regulated activities that the Fund Manager may carry out upon obtaining a licence include: (1) management of portfolios including one or more financial instruments; (2) investment advisory services; (3) intermediation in the sale and redemption of units in investment funds created by other Fund Managers or units in foreign funds; and (4) acting as a representative of foreign funds.

The incorporation of any new Fund Manager is subject to approval by the Polish Financial Supervision Authority (the "PFSA"). This takes at least three months (or much longer if the PFSA seeks the opinion of the relevant authority of another EU member state), and there are qualification requirements for directors of a Fund Manager.

SETTING UP A SECURITISATION FUND

General

In order to create a Securitisation Fund, the Fund Manager must prepare a statute for the Securitisation Fund and enter into an agreement with a depositary (custodian) to maintain a register of the Securitisation Fund's assets. The depositary must be a Polish bank or a Polish branch of an EU bank which has equity of no less than PLN 100,000,000 (approximately €22,500,000)[2].

The Securitisation Fund's statute must define, among other things, the investors' minimum total contribution to the Securitisation Fund.

The Fund Manager has to collect payments from investors in respect of their declared contributions (by way of subscription for the Securitisation Fund's investment certificates). Following subscription, the Fund Manager must submit an application to register the Securitisation Fund with the register of investment funds kept by the court.

The Securitisation Fund's statute can provide for meetings of certificate holders and a board of certificate holders.

Private Securitisation Funds

The establishment of a Private Securitisation Fund does not require a permit issued by the PFSA. In such a case, the Fund Manager is only obliged to notify the PFSA of the establishment of the Private Securitisation Fund. All of the Securitisation Funds created so far are Private Securitisation Funds.

Public Securitisation Funds

However, if a Securitisation Fund is created as a Public Securitisation Fund, the Fund Manager has to apply to the PFSA for a permit to set up the Securitisation Fund.

The Fund Manager should also apply to register the Public Securitisation Fund in the register of investment funds kept by the court after investors make the minimum payments specified in its statute. The application should be made, however, no later than six months after obtaining the PFSA's permit to establish the fund. Failure to apply within this period results in the expiration of the PFSA permit.

A prospectus approved by the PFSA will be required for a public offering or listing of a Public Securitisation Fund unless the relevant Prospectus Directive exemption is available.

A securitisation fund is a type of closed-ended fund used to invest in receivables portfolios.

If a securitisation fund is to be set up as a "private" vehicle, no permit from the regulator is required. Securitisation funds may also be publicly offered and/or listed, in which case they are more heavily regulated (and a permit from the regulator will be necessary).

Securitisation funds typically retain licensed servicers to service the portfolios acquired by them.

Securitisation funds will normally buy the portfolios in true sale transactions. Alternatively, they can enter into sub-participation arrangements.

[2] Also the Polish National Depositary for Securities (Krajowy Depozyt Papierów Wartościowych S.A.) can be retained as a depositary, but we are not aware of cases where it would have actually been so retained.

TYPES OF SECURITISATION FUNDS

There are two types of Securitisation Funds, a Standard Fund and a Non-Standard Fund. This distinction applies to both Public Securitisation Funds and Private Securitisation Funds.

Standard Funds

A Standard Fund must have separate sub-funds. The sub-funds are not legal entities, but their assets and liabilities are distinct from one another. The obligations of a sub-fund may only be enforced against its assets. But obligations that relate to the entire Securitisation Fund bind the sub-funds pro rata to their share in the Securitisation Fund's assets.

A Standard Fund may only make one issue of certificates for each sub-fund. A Standard Fund must invest at least 75% of the assets of a sub-fund in a single loan portfolio. However, a sub-fund may invest in a few portfolios (in which case the minimum threshold of 75% applies to these portfolios collectively) if:

- the originators are domestic banks or EU credit institutions;
- the loans in the portfolios are all of the same type; and
- a sale or sub-participation agreement in respect of each portfolio is concluded within three months of the Securitisation Fund's being registered.

For certain regulatory reasons, Standard Funds may be inappropriate for investments in portfolios comprising non-performing loans (especially because Standard Funds can only invest in pools of homogenous receivables).

Non-Standard Funds

A Non-Standard Fund is designed principally for institutional investors. Individuals can only buy certificates if the Securitisation Fund's statute permits and then only if the issue price of a single certificate is at least the PLN equivalent of €40,000. A Non-Standard Fund may (but does not have to) have separate sub-funds. A Non-Standard Fund must invest at least 75% of its assets (or the assets of each of its sub-funds, if any) by way of the purchase of or sub-participation in specific receivables (or rights arising under specific receivables) and in debt securities. However, the investment in debt securities must represent not more than 25% of its assets (or the assets of each of its sub-funds, if any).

SERVICER

A typical structure of securitisation using a Securitisation Fund includes the engagement of a servicing entity (servicer). Servicers are not required to obtain a permit to execute individual agreements concerning the servicing of securitised receivables, but they must hold a licence granted by the PFSA.

The servicer will usually be a debt collection firm, although in more sophisticated structures it is possible that the servicing is vested in the hands of the originator of securitised receivables (in which case the originator needs to apply for a servicing licence as well, even if it has a general banking licence).

Banks selling NPLs to securitisation funds will benefit from favourable tax treatment. (Such treatment will not be available if the NPLs are sold by a bank to another type of entity.)

A securitisation fund may be available off-the-shelf but it will need to be customised after it is "acquired" by the investors. It may be equally easy to create a "private" fund from scratch as this should not be a time consuming process.

The main role of the servicer is to collect payments from debtors and to manage the entire debt collection process. Usually, servicers also undertake to search for new acquisition opportunities, carry out due diligence of receivables to be acquired and prepare a valuation of them.

INVESTING IN RECEIVABLES

True sale vs. sub-participation

A Securitisation Fund can invest in bank loans either by way of a true sale (assignment), in which case it acquires legal title to the securitised loan receivables, or by way of sub-participation, in which case it acquires the right to loan proceeds, but the originating bank retains legal title to the receivables and continues to be a creditor. For many reasons, it is easier to securitise certain NPLs by way of sub-participation, which ensures the continuity of enforcement procedures and does not require re-registration of mortgages and pledges in the name of the Securitisation Fund investing in the relevant NPLs.

So far, for the tax reasons mentioned below, transactions relating to non-performing loans in Poland have usually been structured as true sale, while (starting from 1 January 2014, when new income tax regulations were introduced) sub-participation is worth considering for performing portfolios.

In the case of a true sale transaction, Securitisation Funds enjoy a concessionary fee for registering the transfer of a mortgage or registered pledge (PLN 100 (approximately €22.50) per registration). The mortgages or registered pledges are not transferred to the Securitisation Fund in the case of sub-participation transactions.

Borrower's consent

There is no specific statutory requirement to obtain the consent of each relevant borrower to securitise non-performing loan receivables. However, contractual restrictions (if any) contained in agreements with relevant debtors may apply. Further, issues relating to the protection of personal data and professional secrecy need to be reviewed to make sure that the transaction can be closed and that a sufficient scope of information can be presented to potential investors as part of the due diligence process. Typically, this is manageable because (within the scope necessary to conclude an agreement for the purchase of bank loans) a Securitisation Fund is entitled to gain access to data relating to borrowers that would normally be subject to bank secrecy rules.

Investment and borrowing limits

A Securitisation Fund may invest in performing or non-performing loans (including consumer loans), but its exposure to a single borrower may not exceed 20% of the value of the Securitisation Fund's assets.

There are also are also restrictions and limits relating to the type of assets that a Securitisation Fund can acquire. For example, restrictions apply to the acquisition of moveable assets constituting collateral for the loans acquired by the fund or where the fund appropriates such assets under, for example, a registered pledge agreement securing the loans acquired by the fund (such assets altogether cannot exceed 25% of a Securitisation Fund's assets).

On the other hand, the investors need to carefully plan the methods of funding to be provided to the Securitisation Fund. The operations of the Securitisation Fund may be financed through equity (i.e. subscription for investment certificates) or debt (i.e. the issue of bonds or through loans extended by a Polish bank, EU credit institution or foreign (non-EU) bank). The issue of bonds must be expressly provided for in the statute, and only Securitisation Funds having a meeting of investors are eligible to issue bonds. There are borrowing limits determining the permissible levels of indebtedness under loans and bonds, based on the ratio of such debt to the net asset value of the Securitisation Fund. Most importantly, the indebtedness of the Securitisation Fund under loans and bonds must not exceed 25% (for standard funds) or 75% (for non-standard funds) of the net asset value of the Fund. As a consequence, until an appropriate level of the net asset value is reached, the initial acquisition(s) of new NPLs can only be financed from the proceeds of issue of investment certificates.

Tax treatment

Corporate Income Tax

Securitisation Funds are exempt from corporate income tax. However, corporate income tax is a critical factor from the perspective of originating banks.

In the case of true sale, the originating bank may deduct the loss on the sale of a loan portfolio to a Securitisation Fund, up to the principal amount of the loans (excluding interest, commissions and fees) if the delay in the repayment of the loan principal exceeds 12 months.

In the case of sub-participation, the originator does not recognize tax revenue when the consideration (equivalent to the 'price') is paid to it, but when the principal of securitized receivables is due or paid. In other words, the originator is not obliged to recognise tax revenue in an amount corresponding to the 'price' at the time of its receipt, but recognition of this revenue is delayed until the scheduled repayment dates of principal of securitised receivables, or until the actual payment date (if the payment is made before its scheduled date). Therefore, the date of recognition of the tax revenue for the originator is deferred, which has a positive effect on cash flow. The tax-deductible costs of the originator in respect of the sub-participation include its "collections" passed on to the Securitisation Fund (comprising principal amounts, interest and other benefits as well as the proceeds of enforcement of security). Taking into account the nature of the costs as being directly related to revenue, from the originator's perspective the date its tax revenue is recognized and the date the cost of earning that revenue is recognized will, as a rule, be the same (and for this reason, originators are not likely to sub-participate non-performing receivables).

VAT

The VAT treatment of the sale of receivables used to be a controversial issue in the practice of the Polish administrative courts and tax authorities, as two contradicting views on the VAT treatment of such transactions emerged. Under the first one, the purchase of receivables was considered to be a VAT-able transaction, i.e. either a debt collection service provided by the purchaser of the receivables subject to the standard VAT rate of 23% or a financial service subject to the VAT exempt regime. The second standpoint was that there was no service from a VAT standpoint and that such a transaction did not fall within the scope of VAT, and accordingly might be subject to civil law transactions tax (CLAT) at 1%.

This discrepancy resulted in a resolution passed by a panel of seven judges of the Polish Supreme Administrative Court on 19 March 2012 (I FPS 5/11), which was largely based on the judgment of the Court of Justice of the European Union (the “ECJ”) dated 27 October 2011 (C-

93/11). The approach of the ECJ expressed in the judgment and followed by a majority of the Polish courts and tax authorities is that a transaction does fall within the scope of VAT if the remuneration attributable to the service supplied by the purchaser of the receivables can be identified, which usually applies to performing loan portfolios. In such a case, the dominant standpoint of the tax authorities and courts is that a securitization transaction can be classified as a VAT-exempt service aimed at the provision of financing to the originator, unless the transaction is classified as a debt collection or factoring service rendered by the purchaser (in which case, the standard VAT rate of 23% applies). However, if no remuneration can be identified and the discount is merely "a reflection of the actual economic value of the debts at the time of their assignment", the transaction falls outside the scope of VAT, which means that it may be subject to CLAT at 1%.

There are no clear rules concerning VAT treatment of sub-participation. Although there are justified arguments to take the approach that sub-participation is a VAT-exempt transaction, which seems to be followed by the administrative courts, certain tax authorities have expressed a view that it is subject to VAT at the standard rate of 23%. It seems that those tax authorities accept that the profit (sub-participation margin) realised on the transaction constitutes the taxable base.

AVAILABILITY OF SECURITISATION FUNDS FOR NEW INVESTORS

In November 2017 there were more than 110 Securitisation Funds on the list published by the PFSA on its website.

Typically, Securitisation Funds are not available off-the-shelf, although some Fund Managers may be prepared to sell or to offer an opportunity to co-invest in an existing Securitisation Fund.

Otherwise, each new investor must arrange with a Fund Manager to set up a new Securitisation Fund (and customised Securitisation Funds seem more appropriate because the Securitisation Fund's statute must reflect the business understanding between the investor(s) and the Fund Manager and certain commercial parameters, e.g. management fees). Of course, this affects the timing of the transaction, and to shorten the process, a prospective buyer of a loan portfolio offered for sale could request that a Fund Manager undertake actions with a view to setting up a Securitisation Fund before it finalises its negotiations. It is possible to enact a statute and then amend it to suit investors' needs. Changes to the statute of a Private Securitisation Fund should be a straightforward exercise.

In addition, any transaction timetable should take into account that typically, between signing a preliminary securitisation agreement and closing (with the Securitisation Fund as a purchaser or sub-participant), there must be some delay while the Securitisation Fund is properly funded. This delay will be much shorter if the Securitisation Fund already exists at the time the preliminary securitisation agreement is signed, but the Securitisation Fund will probably need to increase its capital to finance the acquisition and the necessary procedures will take some time to complete.

Under the Investment Funds Act, a Fund Manager can buy a portfolio before the Securitisation Fund is established and then contribute it to the Securitisation Fund when the Securitisation Fund is registered. However, there are a number of obstacles that may render this option impractical, including regulatory restrictions on the Fund Manager's ability to borrow money, and on the other hand the originating banks may decide that transacting with the Fund Manager as buyer is not practical (because in

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this case, the transaction will be conditional upon successful registration of the Securitisation Fund).

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